

Investing for your “Life-Term”

For many years now, a “longevity revolution” has been slowly and steadily underway. For much of human history life expectancies ranged from 25 to 30 years. Even early in the twentieth century, life expectancy was only between 30 and 45 years. Today, a baby boy born in the United States can expect to live at least 75 years, while girls fare even better with a life expectancy of over 80 years. Since 1840 life expectancy has increased by about 2 to 3 months per year. The reasons for this major demographic shift are numerous and show no signs of abating.

In an age of longer life spans coupled with increased personal financial responsibility (401K plans replacing company pensions, pressure on the Social Security system, etc), the challenge becomes ensuring one’s own financial security. Or, to put it more bluntly, “How does one avoid running out of money before they die?” Because, while governments might bailout large failed institutions, individuals are not “too big to fail.”



The blueprint for making sure we don’t run out of money during our lifetimes is really quite simple. Live within our means, save enough throughout our working life, and invest wisely and with our longer-term goals in mind. The challenge becomes executing this simple plan. Things tend to happen throughout one’s life that can easily throw us off track - we can lose our job, encounter health problems, over spend, or live in a time when the financial markets produce poor returns. All of these things can throw a wrench into the best crafted plan.

In our view there are two categories of “wrenches” that can threaten a well constructed plan. First, are events which occur that are unknown and/or uncontrollable. For example, a decline in the financial markets, an economic recession, a terrorist attack, even environmental disasters (think hurricanes and oil spills) are all examples of things which may occur that are totally out of our control. Second, there are things that we can control but mishandle. Reacting emotionally, even if rationally justified, is a chief example of how we might harm ourselves. For an example look no further than 2009. After a horrendous 2008 and early 2009, investors poured a record \$375 billion into bond mutual funds, pulling almost \$200 billion out of stocks in 2008 and another \$10 billion in early 2009. As a result, many investors missed the equity market’s 26% rebound settling instead for the approximately 2% total return generated by bonds. Unfortunately, many of these investors’ own actions have undermined their ability to build and protect their long-term wealth.

The axiom “invest for the long-term” has become one that many now simply reject. Instead they think, “How can I focus on the long-term if in the short-term my portfolio drops? I just don’t have enough time to make up all the losses before I retire or need the money.” Perhaps instead of thinking about the far-off long-term, a better way to think of it is investing for one’s remaining “life-

term". Our life-term doesn't end on the day we retire. Thankfully it continues throughout our ever increasing life-expectancies. If we don't invest for this longer time period, we run the risk of not having the appropriate portfolio to meet our long-term needs. At Madison, we help you to determine the right portfolio mix for your life-term, with a goal of only taking on the amount of risk you need to succeed.

Allan Sloan, columnist for "Fortune" magazine recently pointed out the following to his readers; "What should you do with your investments if you hear that the Dow has suddenly dropped 1,000 points in 20 minutes? Or that euro-panic has sent stocks swooning? The right answer should be "nothing." Because if you have to worry about a 1,000-point Dow drop ruining your life, your problem isn't the Dow. It's that you're not running your financial life properly. The more violent that market swings get and the louder the shrieking you hear from TV, blogs, and various journalistic advice givers, the more reluctant you should be to engage in any transactions until the madness passes. The worst thing you can do is to obsess over the market, minute to minute. Do that and you'll get whipsawed. You'll buy when people are optimistic about rising prices and the market's expensive, and you'll bail out when pessimism reigns and the market's cheap. One good thing about the 1,000-point drop, though, is that it gives me a chance to dole out advice that may seem shopworn – heck, it is shopworn – but that works very well in both good times and bad. It is that to invest successfully, you need staying power."

It is certainly understandable that during a time of financial market volatility investors are inclined to take measures to protect their capital. The desire to sell volatile assets like equities and hold lots of cash and/or shift more towards bonds would seem like natural steps. However, a portfolio invested for the short-term (lots of cash and bonds) likely will not protect against our life-term needs of protecting the purchasing power of our money and growing sufficient capital to generate sufficient lifetime income. The desire to eliminate short-term portfolio volatility in this case creates a mismatch with what is required by the investment plan designed to meet our life-term goals. Some volatility must be accepted to benefit from long-term equity or equity-like returns. These higher potential returns just can't be earned without accepting the corresponding volatility.

Another issue that often concern's investors is the growth rate of the economy. Interestingly, it appears that GDP growth offers precious little in terms of predicting stock market returns. In a recent article in "The Wall Street Journal", Peter Tasker cited an academic study by Jay Ritter of the University of Florida that analyzed 100 years of data from 16 countries that showed that there was no positive correlation between GDP growth and stock market returns – if anything the correlation was slightly negative.



We think that investors are right to be disappointed with recent stock market returns. The last ten years have been tough and the volatility we've seen in the last decade has not made it easy for anyone to stick with their investment plan. We have all been tested. But we believe that the rewards (returns) will come to those who can maintain an investment plan that's consistent with their life-term goals and needs. This will allow you to live your long life without focusing on the current level of the Dow, projected GDP growth or other uncontrollable events.

"It is sometimes easy to forget just how adaptive and creative businesses are in a changing world and it is this adaptability and creativity that has enabled them to prosper." Managers at Tweedy, Browne Company