Stock Valuations are Not Low

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How can I say this best? Stock market valuations are not low. If you are retired or saving in hopes of retiring, you must laser focus on having a consistent flow of cold cash to pay the tab for your weekly grass-fed-to-the-end beef, fresh-ground flax, coconut milk loaded with medium-chain fatty acids, and omega-3-loaded Country Hen organic eggs. In other words, you will want to rely on high-dividend yields for compound-interest power. The two most important words in investing are "compound interest." Please don't buy into the jive that trying to buy stocks cheap and then trying to dump them on the suckers has anything to do with a conservative compounding story.

The rubber hits the road with a consistent flow of one item – dividends. In my monthly Intelligence Report and at our private investment management company (www.younginvestments.com), I rely on the historical yield range and the DJIA as a conservative investor's best gauge for assessing dividend value. When the

Dow’s yield is between 4.5% and 6.5%, I gauge stocks as cheap. When the Dow’s yield is between 3.5% and 4.5%, it’s neither fish nor fowl. Below 3.5%, I’m not being paid well for investing in stocks. Well, the yield on the Dow, as I write you with ever-increasing concern, is a paltry 3.1%. No, stocks are not cheap, and values are lacking. And while I’m at it, intelligence in Washington is lacking even more!

The Terror of Outliving Your Money

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The terror of outliving your money has now taken hold for too many investors. It’s not hard to see why, given that discerning investors remember like yesterday the 1965-1981 16-year bear market, where the Dow ended up at 875, 10% lower than its 1965 peak of 969. A little closer to home, we all recall with concern the 1999-2008 nine-year bear market, which left the Dow down a frightening 24% from its 11,497 peak of 1999. For all retired and soon-to-be-retired investors, there is a fast and hard lesson to be learned here. Look to dividends and interest and the miracle of compound interest. Let capital appreciation come as it may or, as I have shown, may not. My *Retirement Compounders Program*, outlined monthly in my *Intelligence Report* and at my family investment management company (younginvestments.com), will guide you.

WARNING! Avoid the Catastrophic Thinking of Retirement Investing

Ah, retirement. Congratulations. You made it. Whether you got here by selling your business or working your way through corporate America, you've made it and you must feel relieved, excited, and probably a little nervous. Your retirement years should be some of the best in your life. But they are also some of the most nerve-racking, with no job to easily fall back on. With this in mind I've constructed a list of potentially catastrophic thoughts you might have and how to handle them. Picture yourself 10 years from now with the memories you might have of you and your spouse with grandchildren, friends, or relatives, or of trips to places you always dreamed of seeing. Imagine how great you'll feel if you remember that you enjoyed the moment. Secure finances can help you do that. So let's get started.

Catastrophic Thought #1: I'm retired. I have all the time in the world to manage my money.

You will have plenty of free time and access to information when you're retired. Unfortunately, access to more information does not mean more wisdom. Knowing how to achieve long-term investment success is a craft. It is part art and part science that takes years of seasoning and discipline to do well. Try to spend your time defining your goals and objectives as you construct an investment plan. Don't seek exciting investment ideas. Keep it simple and don't worry about your portfolio being boring. You didn't get here by being foolish with your money, so practice being smart about what you invest in so you can enjoy the time you spend with your loved ones. Imagine how at peace you will feel knowing you're leaving your spouse in a position of financial strength.

Catastrophic Thought #2: It won't happen to me.

Everyone thinks they can avoid the next disaster. In reality they can't, and it's an expensive lesson. Very few predicted the demise of Long-Term Capital Management, the dot-com bust, 9/11, the war in Iraq, or the subprime-mortgage meltdown. Moral: If CEOs of the major banks didn't understand the risks they were carrying, how could you?

Expect more disasters in your lifetime and prepare to manage your portfolio unemotionally. In retirement you're managing more money than ever, making it a daunting task. You may find that you sell too early or inertia sets in. If this is you, then seek help from an advisor. You may question your trusted advisor during the next disaster, but your emotions should not impact his or her decisions. Oftentimes it's the patient investor who profits when others head for the hills.

Catastrophic Thought #3: I'm not like the rest

because I’m a contrarian investor.

By definition not everyone can be a contrarian investor. But that’s exactly how investors described themselves in a recent poll. Rather than investing with the herd, you may want to become an expert in understanding risk in your portfolio. Only you know the level of risk you can stomach. You may find your tolerance for risk is lower than you thought. If so, make the appropriate changes and sleep better at night.

Catastrophic Thought #4: I paid how much in fees?

Seven of the ten largest equity mutual funds are offered by one company and carry a 5.75% front-end load. You can see this in the Wall Street Journal on page C4 under “How the largest mutual funds did.” Scanning down the page to the largest bond funds, you’ll notice the same company offers a bond fund with a front-end load of 3.75%. A front-end load is an upfront fee a broker receives when selling a mutual fund to a client. Loads are an unnecessary cost if there’s a similar no-load fund available that investors can buy on their own. The fact that seven of the ten largest equity funds carry loads illustrates my belief that investors are sold what they own. I’m not so sure all the advice investors receive is in their best interest.

Catastrophic Thought #5: We need to get to $X to retire comfortably.

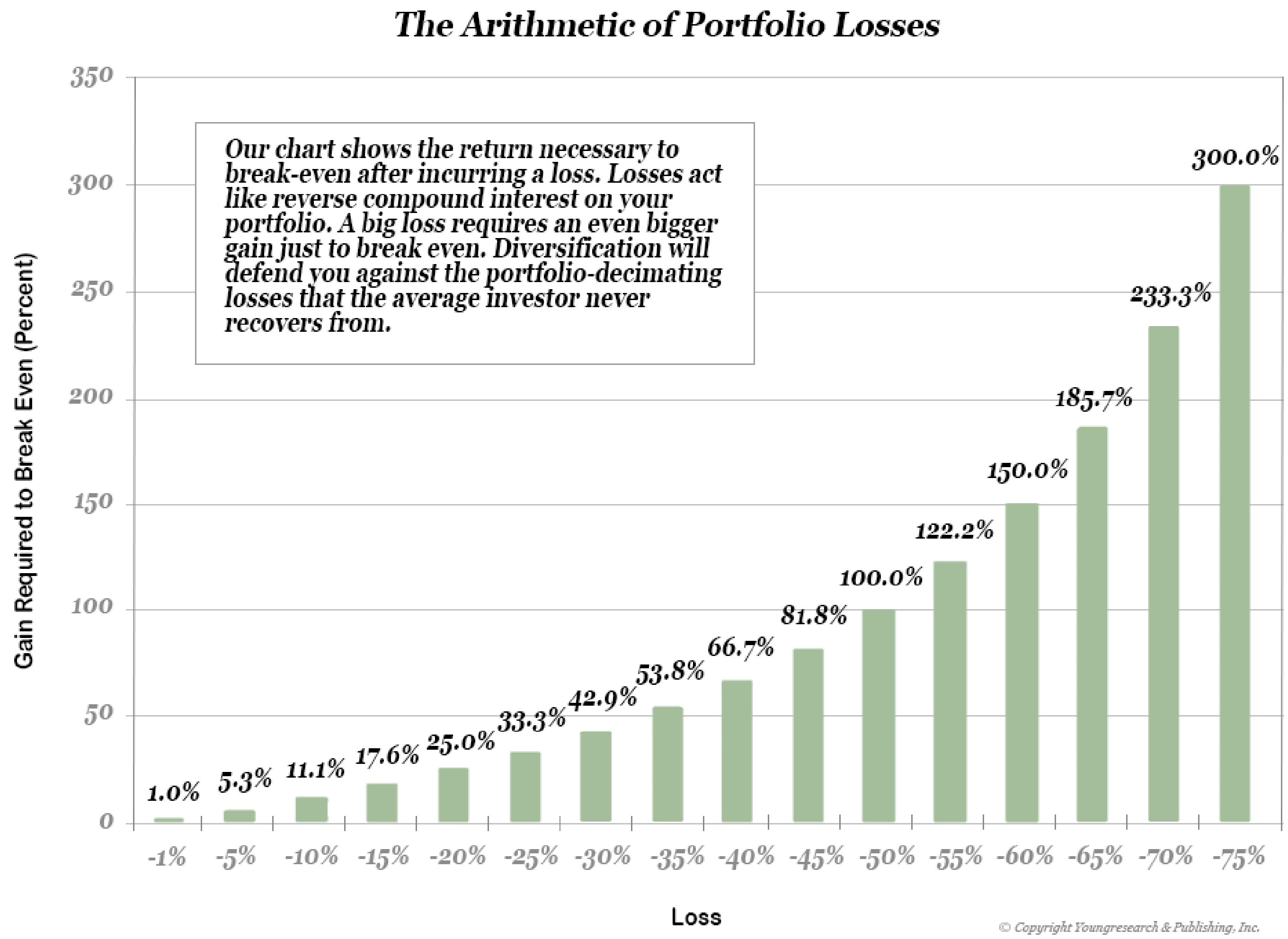
A sure recipe for disaster is when you feel you need to be more aggressive to get your portfolio to a certain preretirement level. Being aggressive when you’re 30 is fine because you have time to wait out the market. But when you’re in your late 50s or early 60s, aggressive means a higher probability of losing money in retirement. Now is not the time to lose money. It’s hard to come back from market losses. You don’t want to be deprived of taking a once-in-a-lifetime trip just because the market falls.

Catastrophic Thought #6: We can spend 8% of our portfolio per year.

At 4% spending, you and your spouse shouldn't outlive your money. I'd be concerned about the longevity of a portfolio exceeding this annual withdrawal rate. Try to live within your means. You don't want to be seeking employment in retirement. Your retirement spending should be part of a plan, not an impulse. Imagine how proud you'll feel being able to share with your children how smart you have been with your money.

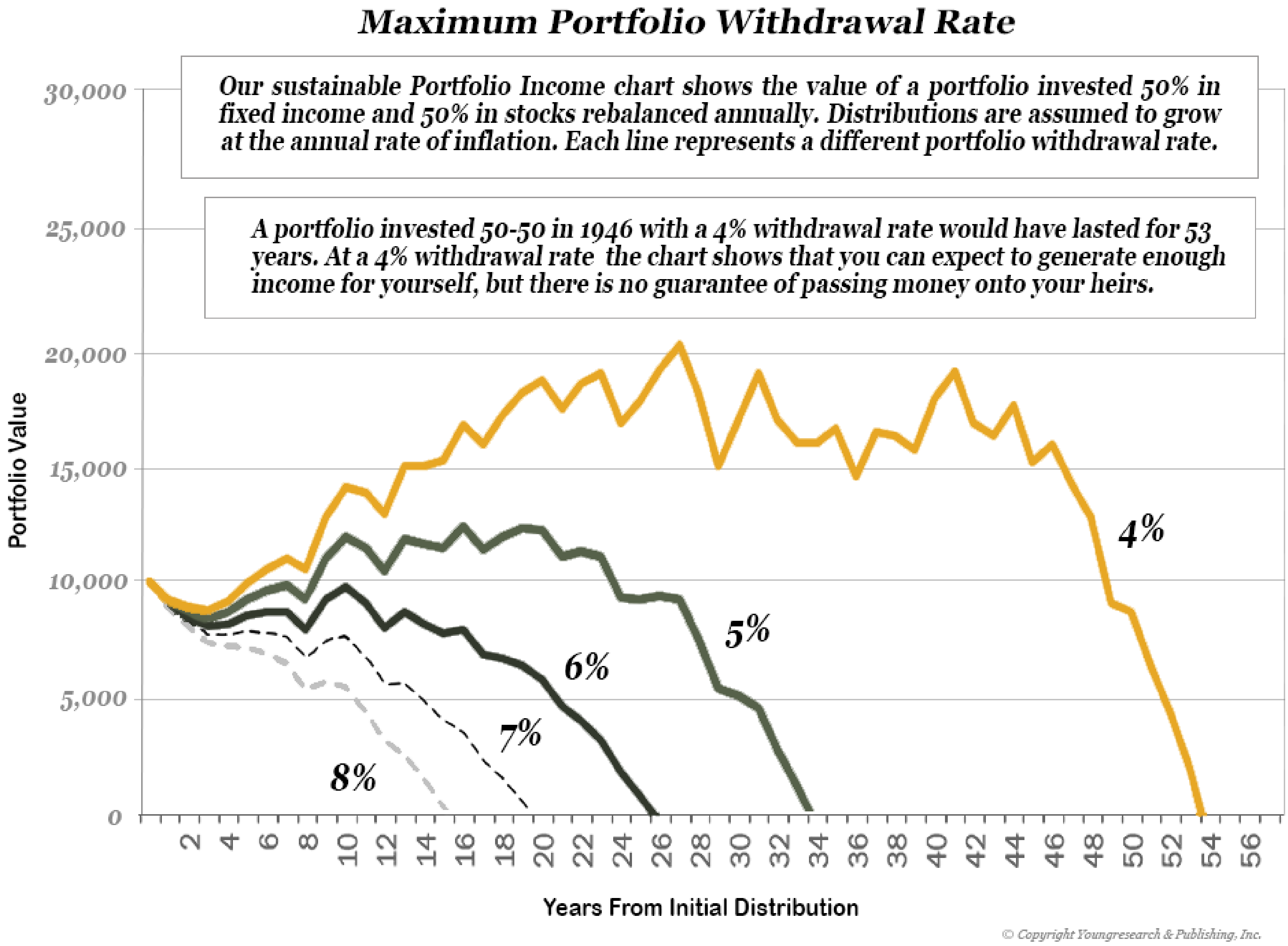
Catastrophic Thought #7: Market volatility is over.

In a recent WSJ article, "Rough Waters Are Market's Rule," the low volatility of recent years is discussed:
"In late 2006 and early 2007…[the S&P 500] dropped into the lowest 3% of all periods since 1950," says Ed Easterling, director of Crestmont Research. "Easterling goes on to say that the smooth sailing seems to have ended. Since the early 1960s the average daily trading range has been around 1.4%. After a stretch from 2003 to mid-2007, when the average range was under 1%, it has increased to more than 2%. The market could now see an average daily swing of +/-2%. Having the right mix of investments helps reduce volatility and puts you in a position of strength by not being forced to sell at the wrong time.



Catastrophic Thought #8: I take out $X per quarter.

If you do your quarterly income planning for the year based on prior year-end values, you may overspend drastically. For example, if at year-end your portfolio is at $3,000,000, you calculate $120,000 as your 4% annual draw. You tell your broker to send you 1% or $30,000 per quarter beginning right away, leaving you $2,970,000. If volatility is here to stay (see “Catastrophic Thought #7”) and you get caught on the wrong side of a 2% swing, your portfolio could be worth $2,910,600 after the first quarter. At the beginning of the second quarter, you take your second quarterly $30,000, leaving you with $2,880,600. Your portfolio declines by $120,000, but you’ve only spent $60,000. At this pace, you’re depleting your portfolio by 8% annually. I recommend a withdrawal rate of 1% or $30,000 per quarter, whichever is less. If you follow this recommendation, you’ll be keeping your promise to not exceed the 4% per year. If you can do this, then chances are you’ll be at peace with your portfolio in old age.



Catastrophic Thought #9: Bonds are boring.

As you approach retirement, you need to make sure you have a solid bond component. I would estimate as much as 50% to be an appropriate starting point. In a front-page Wall Street Journal article, “Stocks Tarnished by ‘Lost Decade,’” E.S. Browning reviews what has been a most disappointing decade for many soon-to-retire or retired investors:

Over the past nine years, the S&P 500 is the worst-performing of nine different investment vehicles tracked by Morningstar, including commodities, real-estate investment trusts, gold and foreign stocks. Big U.S. stocks were outrun even by treasury bonds, which historically perform much less well than stocks. Adjusted for inflation, treasuries are up 4.7% a year over the past nine years, and up 5.8% a year since the March 2000 stock peak. An index of commodities has shown about twice the annual gains of bonds, as have real-estate investment trusts.

You want to work with someone who can help you craft a balanced portfolio. You don’t want to miss the boat in the next decade.

Catastrophic Thought #10: Compound interest is for younger investors.

You want to gauge your expectations to the market you’re investing in. In the past, stocks returned about 10% per year (6% growth, 4% dividends) on a P/E backdrop of 15. With today’s P/E of 18 and dividend yield of 2%, a 7.5% return is implied. If you invest $1,000,000 and reinvest your dividends over 10 years at an annual compound return of 7.5%, you’ll have turned your $1,000,000 into $2,061,031.56. It’s with the help of compound interest that your money doubles in 10 years. You’re never too old to let interest on interest work for you. I think you’ll agree that making money while doing nothing is a pretty good job description in retirement.

You hopefully found this list to be helpful in getting you thinking about investing in retirement. Do your best to avoid these catastrophic thoughts and you may avoid having to learn the hard way. Share this list with a loved one or a friend and enjoy your retirement. You’ve worked too hard to be deprived of the stress-free retirement you deserve.