MIDLANDS BUSINESS TRENDS

# The benefits of having an investment plan

by Charles B. Flowers, AIF®

Investment management is a long term journey, even for individuals nearing retirement. In 2009 the average life expectancy for a 65 year old was 18.8 years. Just think how much has happened in the world over the past 18.8 years. The next 18.8 years will hold more discoveries and opportunities and the stock market will benefit. There will also be unexpected surprises and challenges with which the world will have to deal. Regardless of the economic environment, the following investment fundamentals: doing your homework, reviewing your plan, rebalancing your portfolio, and controlling your emotions will continue to serve you well over the next 18 months or the next 18 years.

Saving is crucial to meeting retirement goals. The problem with saving is when consumers and businesses begin to aggressively save (or aggressively spend) an avalanche of adverse economic events begins because the economy runs on spending and investing. Economic growth is the combination of consumer spending + business spending + government spending + net exports (what a country sells to foreigners minus what a country buys from foreigners). Currently in America, the government is the only entity spending. The concern with government spending is the need for change in how the United States government spends. In the meantime, if the economy is to expand, people are to find jobs, and the stock market to go up, we are stuck with relying on government spending until consumers and business begin to spend again.

Increasing government debt presents a tricky situation for bond investments. If government bond buyers decide they want higher interest rates to compensate for extra risks associated with lending to highly indebted governments, then the value of existing bonds will go down. A decrease in bond prices will not be a major setback for individuals who hold bonds to maturity but inflation generated from economic growth or governments trying to slowly print away their massive debts will present a problem for bond investors. Since inflation is a gradual and barely visible force, bond investors will slowly experience erosion of the purchasing power of coupon payments. On the other hand, if the economy enters a recession investors will most likely flee to the safety of government bonds.

While the bond market weighs the different paths that governments may take, the stock market is busy trying to weigh the different economic possibilities that the world may face. One main function of any market is to absorb news and turn news into prices and because of the uncertainty in today's world, the stock market swings wildly back and forth. While uncertainty is high, the underlying fundamentals of the stock market look good: business profit margins and cash balances are high, prices for many stocks are low, and the dividend yield on many stocks is higher than bond coupons on United States Treasuries. These attractive company fundamentals create an interesting topic for investment commentators in regard to the benefits of dividend yielding stocks. There is no doubt that stocks have many appealing attributes, but if the world enters another recession stock prices will most likely fall.

Market timing sounds appealing. However, correctly timing the market is almost impossible. For example, from January 1, 1970 to December 31, 2010, a $1,000 investment in the S&P 500 Index grew to $49,614. If the investment missed the best 25 days in that 40 year period, the $1,000 investment would only have grown to $11,889. During the same period an investment of $1000 in one-month United States Treasury Bills would have grown to $9,186. Missing out on short and powerful stock market rallies is one of the dangers of market timing.

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Currently, every investment option has a strong positive and a strong negative side. Saving is essential, but when everyone saves and no one spends the economy suffers. Bonds offer great protection and security in an uncertain environment, but the long term implications of large debt and inflation must be taken into consideration when choosing the types and maturities of bonds in which to invest. Stock fundamentals are strong, but many investors are worried about another recession. Market timing sounds appealing but there are many dangers associated with trying to successfully time the market. With a good investment plan you will be in a much better position to effectively control your emotions and make decisions that help you achieve your long term goals.

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