The Main Advisory

Fourth Quarter 2013

Piecing It All Together www.MainAdvisory.com

What's a Retiree to Do?

Retirement doesn't mean that the bills stop showing up in the mailbox, travel destinations become dreams, or grandchildren stop expecting occasional surprises. I'd be the first to argue that retirement is similar to being on vacation 365 days. If you are like most vacationing Americans, you spend more on vacation than you normally do at home. Income is as important in retirement as it is at the height of a career.

Source: U.S. Government Treasury Department

Retirement income often comes from multiple sources. For some, there is a reliable pension income. While it rarely increases with the cost of inflation, it provides a "peace of mind" income stream that you can't outlive. Traditional pensions have all but disappeared but for a small portion of the population. Social Security is a very valuable benefit that usually does include an annual cost of living increase. However, Social Security payments rarely cover the monthly living expenses for most retirees. Some retirees are fortunate to "consult" with their previous employer or industry leaders to supplement income and still have the flexibility to enjoy hobbies and other interests. But, the real engine behind financial security and income in retirement will most likely come from investments that accrued while working.

Early in my career dating back almost 25 years ago, the rule of thumb was that a portfolio should be allocated between stocks and bonds based on age. For example, a 65-year-old should have 65% in bonds and 35% in equities. As age increases, the bond allocation was to grow, too. For those who have been in retirement for the past thirty years or so, this strategy could have been rather beneficial. But … (Hang tight with me, while I digress into a small educational reminder about bonds).

Bonds possess two possible elements of return. The issuer is borrowing money and agreeing to pay a certain interest rate for the privilege over a defined period of time. When you buy a bond, you act as the lender. If you buy a bond today that matures in 10 years paying an annual interest rate of 2%, and attempt to sell it next year when interest rates have risen to 4%, you must agree to take less than what you paid in order to entice the buyer to purchase your bond. After all, he/she could buy a new one that pays 4%. So, when interest rates rise, bond prices fall. The inverse is also true. When interest rates fall, bond prices rise, thereby providing a win-win all around; the investor receives the interest payment and appreciation!

Look closely at the chart to the left showing the rise and fall of interest rates dating back to 1962. From 1962 to 1982, rates climbed from 4% to 16%! Bond investors were losing principal value almost annually. Thankfully, from 1982 to the present, interest rates have been falling. Remember, falling interest rates translate into rising bond values. While yields on the bonds continued to fall, price appreciation took up the slack. So, retirees could maintain a respectable income stream and lifestyle. Keep in mind that falling interest rates have been a 30-year trend.

Interest rates for the 10-year Treasury note actually fell below 2% in 2013, the lowest in more than 50 years. They can't go below 0%. The risk is high that rates will trend upward, and bond prices will begin falling. We got a little taste of this in July when Federal Reserve President Bernanke hinted at tapering his bond-buying stimulus program. So, what's an investor to do?

My study group recently met in New York City at the World Trade Financial Center headquarters of Oppenheimer Funds. We were offered an empty conference room overlooking the new 9-11 Memorial. The President and Chief Investment Officer of Oppenheimer, Art Steinmetz, joined us for a conversation about "bond risk" over lunch. Mr. Steinmetz has been

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immersed in bond investing for decades. His comments were sobering and straightforward as he shared his opinion that bond investors will be in for a period of only coupon/interest rate return, coupled with occasional losses in value *when* rates rise. He spends much of his day evaluating "alternative" asset classes to purchase inside the bond funds to mitigate downside risk when interest rates rise. However, each addition must be carefully (mathematically) modeled so that the portfolio doesn't become too correlated with the stock market; jumping from the frying pan into the fire is not the object of "risk mitigation." Many of the "alternative" asset class strategies are untested for long periods of time, so bond managers are faced with a huge dilemma. Moreover, most investors have only had good experiences with bond investing. It is difficult to convince investors that the future might be different until it is too late.

Art Steinmetz isn't alone in forecasting flat, perhaps even losing, bond returns into the foreseeable future. The Securities and Exchange Commission posted an Investor Bulletin on their website in June 2013 entitled "Interest Rate Risk — When Interest Rates Go Up, Prices of Fixed-Rate Bonds Fall." FINRA, the regulatory body governing most investment firms, also posted an investor notice with a similar title. Earlier today, I heard an interview with Charles Kantor of Neuberger Berman, who said "fixed income is likely to return near zero in the next three years."

Evidence is mounting that the way portfolios have been managed for the past thirty years is in need of a thorough review. The buzz phrase today is "alternative investing." Personally, anytime I hear the phrase, I begin to shiver. It could mean *untested in the real world* or illiquid, perhaps both. Each individual situation needs carefully evaluated, weighing one "risk" against another. Seeking the expertise of investment managers who have "risk" management processes in place is of utmost importance in addition to engaging in conversations with you.

A rule of thumb is only a suggestion, but not the mandate. So, for a while, investors might be best served if the age-based allocation to bonds proposition is tucked into the archives for a spell. ■

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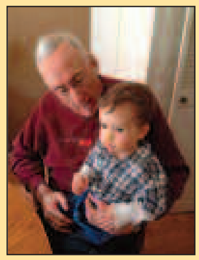
Darla D. Main, CFP®

President and CEO of Main Advisory, Inc.

A Tribute to Two Special People!

I'm so fortunate to congratulate two wonderful people in my life upon turning 90. Leah, my mother-in-law, had a big celebration with her children and long-time friends in September. Glenn, Jr. (Dad) turns 90 on December 9th. They are models for aging gracefully as both continue to be active and navigate the Baltimore traffic easily.



Glenn Jr. and Mac

Dad is a graduate of Virginia Tech and continues to follow every football game for the university. His first job out of college was with the railroad as a mechanical engineer. He recently told the story of taking the "maiden voyage" on the first diesel engine from Pittsburgh to Butler. Dad transitioned from the railroad to the insurance business soon after marrying and continued in the business as an instructor for continuing education into his 80's. As a way to keep active, he spent a season as an usher with the Baltimore Orioles after officially retiring, much to the delight of his grandsons!

Leah and Mason

Leah grew up on the Eastern Shore of Virginia and always has a myriad of stories to share about her home place, her father, and her special pony. After moving to Baltimore as a young single woman, she made a career in the court as the administrative assistant to several judges. She is a whiz at writing cute poetic jingles that make us chuckle. Together, we enjoy sipping cappuccino and shopping excursions when we visit one another.

Mac, Elliot, and Mason are SO blessed to not only have two sets of grandparents, but two sets of Great-Grandparents, too. Happy Birthday, Dad and Leah!

Echoes of the Past

Warren Buffet, arguably the most famous living investor in the U.S., has a quote that I display in my office that says "Be fearful when others are greedy. Be greedy when others are fearful." This is a wonderful everyday "gut check" reminder about investing.

On a scale of one to ten, I fear we are at a nine on the "greed" meter. I'm no prophet or economic forecaster, but this is not my "first rodeo" either. Here are some headlines and a few of the highlights embedded in articles I've accumulated recently:

Meltdown Ahead: Ride Market's Last Gasp Rally
by Jim Jubak

"Melting up, then melting down? As the term implies, with its echo of 'melt down,' stocks can fall hard after a melt up.

In a melt up, valuations run far away from any fundamentals in the economy, the market, or individual stocks. A melt up is driven by momentum, as investors who have profited from the market's gains greedily chase more and as investors who have been on the sidelines decide that they can't take missing out any longer and join the party. Worries about risk go out the window, and often it's the riskiest assets that climb the fastest. In a melt up, the last of every group of investors, except the permanently bearish, throws in the towel and finally puts cash into the market.

A melt up can be the last blowoff before a market dive."

Is this Market "Overbought?" Is it Time to "Taper" Your Portfolio? by Gary Alexander of Navellier & Associates

"With this slow-growth economy souring the mood of America, why is the market setting new all-time highs every other day? Are we overdue for a correction or even, heaven forbid, an end to the bull market?"

Dot-Coms Party Like It's 1999
Wall Street Journal, October 28, 2013 (Remember what followed 1999?)

"Twitter Inc. plans to go public at a value of $11 billion, without turning a profit…

Now, shares of Internet companies are soaring again, and signs of pre-2000 exuberance can be seen in Silicon Valley and nearby areas.

*Social networks such as Twitter and Pinterest are drafting off the success of Facebook Inc., which sports a market value of $126.5 billion, or about **70 times** [my emphasis] next year's expected earnings."*

Blackstone Pro Sees Signs of Market Speculation
CNBC, October 25, 2013

"With stocks sitting near record highs, one Wall Street veteran is sounding the alarm. 'There are signs of speculation out there, and that makes me worried,' said Blackstone Advisory Partners Vice Chairman Byron Wien.

Wien has maintained a cautious tone all year, warning that the market would be dragged down in the second half of 2013 by disappointing earnings. But the idea of a frothy market is something new for the strategist, and he blames investors as well as the Federal Reserve's easy money stance…

Wein added, 'The feeling is that we're OK for a while and everyone thinks they're smart enough to know when the music is going to stop.'"

Investors Pile on Record Debt to Buy Stocks at Record Highs, CNBC, October 23, 2013

"With stocks near all-time highs, investors are taking on record levels of margin debt, something that could accelerate a decline if the market turns south.

Margin levels, or the amount borrowed to purchase securities, climbed to a new record of $401 billion in September…"

I was a bit taken aback with the subject line of a recent email inviting me to participate in an educational conference call with a well-known and somewhat prestigious investment company. It read "What To Do When Markets Go Well." Here's how the message began: "Markets move up and down and there's nothing we can do about it. But what we can do is make sure our clients are prepared — with portfolios that are built to help withstand market fluctuations and with the information they need to keep from making unwise decisions." It ended with this "join … as they present ideas on how to talk to your clients today to prepare them for tomorrow." Needless to say, this is a company with a strong buy and hold philosophy. I didn't register for the call, but I suspect there will be lots of charts showing how investors have always bounced back from market downturns in the past.

As a veteran in the financial industry, I caution against chasing returns. Admittedly, it has been a good year for equity investors thus far, but the year is not over. It pays to heed the advice of successful investors like Warren Buffet and perform a "greed check" routinely. One of our investment managers frequently states, "A return of your capital is more important than a return on your capital." ■

OUR TEAM!

The Main Advisory Team. Suzanne Campanella, Lauren Peck, and Darla Main.

Darla Main - President, Main Advisory, Inc.

I would be remiss if I didn't share the births of Elliot on July 8 and Mason on July 31. They've moved in on Mac's territory who is an absolute bundle of entertainment at the age of two. Both Elliot and Mason have developed infectious personalities complete with oohs, aahs, and an occasional giggle. Elliot has taken the lead in the weight category, but Mason appears to be nipping at his heels. Our home becomes one non-stop buzz of noise and diaper changes when everyone visits at once. The holidays will be quite interesting this year!

Lauren Peck - Assistant Director of Investments

In early October, when the Pittsburgh Pirates still had a shot to beat the St. Louis Cardinals in the National League Division Series, I was presented with an awesome opportunity to be a part of the action. My friend's father, a photographer for the Associated Press, asked if I would be a "card runner" during a couple of home playoff games. This entailed me running onto the field every half inning to retrieve full memory cards from several photographers and then running them to a press room inside the stadium to be processed. My "media" credentials granted me behind-the-scenes access that I will never forget. I was bumping into players and coaches left and right and was able to watch the games from some of the best seats in the house – on the field. It was thrilling and exciting. While I'm disappointed that the Pirates weren't able to advance to the NLCS, I was excited to witness the Pirates' first postseason appearance since 1992.

Suzanne Campanella - Client Services

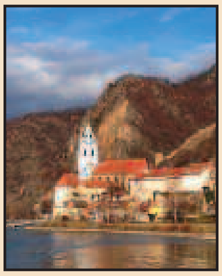
Because my grandmother Cora was born in the early 1900s in a one-stoplight town in rural Tennessee, it was a natural fit that I would find *Nothing Daunted* by Dorothy Wickenden such an enchanting read. It is a true story, set in 1916, of two society girls who agree to travel to Elkhead, CO – *out west* – to teach school for one year. Neither had a teaching degree but both had gone to Smith College. Dorothy ends up with a dozen children from grades 1-5 and Rosamond has six or so in high school. They ride horses three miles (roundtrip) to and from the two-room school and "soon started wearing spurs, which reduced their ride by almost fifteen minutes." This narrative touches on suffrage, building The Moffat Road (part of Rollins Pass located on the continental divide), coping with snow and temps below 40, the resounding hospitality and resilience of the homesteaders, and yet most of all, Dorothy and Rosamond's amazing zeal.

JOURNEYS & TRAVELS

...down the Danube

A*s Darla writes*, "Our dear friends enticed us to join them for a European Christmas Market Riverboat cruise last December. For the record, I am not a fan of cruises, but this was the most fabulous way to see many beautiful places in Europe. We boarded in Passau, Germany and sailed the Danube to Budapest, Hungary over the course of a week. The boat was decorated festively for Christmas, the food was gourmet all the way, and the best part was not packing and moving to a new hotel each day. Every day was comprised of a morning sightseeing tour of a new city; we sailed mostly at night. The afternoons were for shopping the Christmas markets and sampling the "Gluhwein" (hot mulled wine) to keep our noses and hands warm.

The cities in Europe are magical at Christmas. Unlike the U.S., decorations are mostly made out of natural materials like wool and wood/twigs. There is a sprinkling of white lights that sparkle like diamonds beneath a fresh layer of snow. People of all ages pour onto the streets, including babies bundled in sheepskin blankets where only little red noses and two bright eyes can be detected peeping from beneath, to enjoy the festivities. You can't help but catch the spirit of the season that spreads through the chill in the air.



Because we so enjoyed our first experience, we have made reservations for another one in 2014 to sail through the Dura Valley in Portugal. The boat is the newest in the Uni-World fleet, so we are very much looking forward to another great adventure with great friends." ■

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