



# I N V E S T O R

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THIRD QUARTER 2013



"Concerns over interest rates are foremost. The problem is exacerbated because future decisions are data dependent, and the Federal Reserve is no better at economic forecasting than anyone else; further, there is dissension within the Fed, and the various members are taking their views public."

David Dietze, JD, CFA, CFP  
CNBC, June 27, 2013

## Stocks Surge, Bonds Bleed in 2013's First Half: Game Plan for the Second Half

By David G. Dietze, JD, CFA, CFP™

Equity investors had much to celebrate in 2013's first half. Not only did both the Dow and the S&P set new all-time records, but their year to date returns are stellar. As we approach the year's halfway mark these indexes are up nearly 13% in the case of the Dow, and 11.7% for the S&P, and that doesn't include dividends.

Bottom line, investors have recouped all their losses from the 2008 downturn, vindicating a stay the course strategy. Plus, they've earned returns in just the first half exceeding the normal for an entire year.

On the other hand, for bond investors, 2013 has been nothing but pain. The broad based Barclay's Aggregate bond index now sports a loss of nearly 3%, and that's including interest payments. That makes cash's return of nil look pretty good in comparison. The difference in the first half returns between stocks and bonds, up 11.7% for stocks and down 3% for bonds, is one of the sharpest on record.

*"The difference between stocks' and bonds' first half returns is one of the sharpest on record"*

The 10 year Treasury, with a slightly longer maturity than the Barclay's Aggregate, has fared worse, down a full 5%, even including interest payments. Of course, with the 10 year Treasury yielding a mere 1.76% at the start of the year, many reached for fixed income with more yield.

### The Fallout From Reaching for Yield

Investors sought more yield in two ways. The first was by investing in bonds with longer maturities. But, that courts more risk when rates rise, as we saw in the first half. The 30 year Treasury sank a full 10% so far this year, despite the higher yield, while long dated munis, a favorite for investors chasing greater tax exempt income, have dropped over 13%.

*"Investors have recouped all their losses from the 2008 downturn, vindicating a stay the course strategy"*

Others reached for more yield overseas, particularly in the emerging markets, accepting greater credit risk in exchange for more yield. Unfortunately, that proved costly, too, as bonds from those regions have dropped 9.4% so far this year.

Domestic high yield offered some refuge, but these bonds returned less than their yield, just 1.5% so far this year, a pittance relative to stocks, and not enough to offset their higher credit risk.

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## Stocks Surge, Bonds Bleed in 2013's First Half: Game Plan for the Second Half... *continued from page 1*

### End of Half Turmoil

By the end of the half, storm clouds rumbled across both stock and bond markets. The catalyst was the Federal Reserve chief Ben Bernanke's warning that bond purchases could be "tapered" off by the end of this year, and further monetary stimulus ended by the middle of next year.

Despite everyone knowing that eventually the punch bowl (meaning extraordinary infusion of money into the system pushing interest rates down) would be taken away, markets were jolted by the cry of "last call." Stocks had their worst two day slide in several years, and markets have slipped 4.6% from their highs. Meanwhile, over in the normally placid bond market, interest rates had their biggest surge since the 1990s.

So, that was the market's first half. What should investors now expect for the second half, and how should they prepare?

### Expect Greater Volatility in the Second Half

Until the 4.6% sell off in the markets this month, 2013 had seen little volatility. Recent years have experienced much bigger sell offs, albeit temporary and followed by rebounds. There's no reason to expect we are immune in 2013's second half. In 2009, the market sold off 28% before rebounding. There were also temporary dips of 16% in 2010, 19% in 2011, and 10% last year.

The CBOE volatility index, a key measure of the market's expectations of near term volatility, has surged from close to 11 to 20, suggesting more turmoil ahead. We don't think the relatively placid market conditions in most of 2013's first half will have an encore.

We saw how abruptly the market reacted to changes in the outlook from the Federal Reserve. As it becomes increasingly itchy to reduce the size of its balance sheet amid criticism that it's pumped too much money into the system, brace yourself for further gyrations as its policies adjust. Indeed, there seems to be internal disagreements within the Federal Reserve; one of its members, James Bullard, came out last week with a sharply worded criticism of Mr. Bernanke's approach. Keep your seatbelt fastened.

### Asset Allocation Strategy: Rebalance Now

Given the size of the differential between the year to date returns on stocks versus bonds, there's rarely been a more appropriate time to sell some stocks and buy some bonds. At a minimum, you are reducing risk by trimming your exposure to stocks. You would be buying low and selling high, a concept that makes all the sense in the world, but most do not put into practice.

In any event, you certainly wouldn't want to get more aggressive with stocks, given that you'd be paying 10% or more



relative to the start of the year. With the ten year Treasury yield now at 2.5%, up from 1.67% at the start of the year, if you were inclined to exit the bond market, you should have sold at the beginning of the year.

Somewould argue that you should have a preset date to rebalance, and that might be, say, at the end of the year. However, with the magnitude of the moves since the start of the year, taking advantage of trimming now your equities given that they are just 4.6% off their all-time highs is compelling. Reinvest equity sales into bonds to get a

yield nearly 1% more than was offered at the start of the year.

### Following Rebalancing, Stay the Course

The rationale to simply sit tight with your first half portfolio: There's been no change in the fundamentals. The latest gyrations in the markets will not affect the sales of **Coca Cola, Merck,** or tobacco marketer **Lorillard.**

Economists say the ratcheting up of 30 year mortgage rates from 3.5% to 4% will have little effect on home buying, now that lenders are loosening their standards a bit.

No matter what happens to interest rates, your bonds will still come due at the scheduled time and, absent default, you will profit as planned.

Besides, all the prognostications and warnings of higher rates may not come to pass. The Federal Reserve failed to forecast the subprime crisis, so why is it so prescient now? Bottom line, a very logical response is to ignore the latest tempest over interest rates or Mr. Bernanke, and sit tight with your investments.

### Have Extra Cash to Invest? Buy Quality Stocks at Reasonable Prices

Stocks today are priced very reasonably, at about 15.7 times forecast earnings, in line with valuations prevailing on average over the last 50 years. Even given today's higher 10 year Treasury rates (2.5%), earning an effective earnings yield (the inverse of stocks' price to earnings ratio) of about 7.5% on stocks provides plenty of incentive for investors to continue to buy equities.

Two important reasons why interest rates rise is first, greater loan demand due to a strengthening economy, and second, rising inflation expectations. Either reason would make stock a more attractive opportunity than fixed income.

For a fuller version of this article log on to <http://www.ptview.com/files/getting%20ready%20for%20the%20second%20half%20article.pdf>

*"Despite everyone knowing that eventually the punch bowl would be taken away, markets were jolted by 'last call.' "*

*"The Federal Reserve failed to forecast the subprime crisis, so why is it so prescient now?"*

## Your Shrinking Retirement Plan

By Claire E. Toth, JD, MLT, CFP™

President Obama's budget, released earlier this year, would limit how much investors could accumulate in retirement plans and limit flexibility for those who inherit retirement plans from a non-spouse. No one thinks any of this is about to become law, but once an idea is floated in Washington, it can provide the seed for future legislation. With Congress and the President searching for ways to raise



revenue without raising tax rates, don't be surprised if some variation of these proposals takes shape in the next few years. Expect inter-generational transfers to be a specific target, with some interesting collateral damage.

### Retirement Savings Limits

The centerpiece of all this is a lifetime cap on retirement plan savings. That cap is a moving target—it is the amount a 62 year old would spend to purchase a lifetime annual annuity of \$205,000. That's the current limit on traditional, defined benefit plans. Right now, that translates to a total retirement account balance of about \$3.4 million. However, the cap is based on multiple factors, and a change in any of those underlying factors will change the lifetime limit.

*“Once an idea is floated in Washington, it can provide the seed for future legislation”*

The good news is that the \$205,000 annuity amount is adjusted annually for inflation. The bad news is that the lump sum needed to purchase the annuity assumes an investment return tied to long-term Treasury bills. The lower the interest rate (and hence the lower the presumed investment return), the higher the lump sum needed. We all know that interest rates are at historic lows. At some point, they are going to rise. When those rates rise, so will the presumed investment return. The result will be a smaller account balance needed to purchase that annuity.

If long term Treasury rates were to rise to four percent—what many investors

think of as their typical yield—that would reduce the lifetime retirement savings cap to \$2.56 million. Remember the late 1970s, with double digit inflation? Treasury rates were in that ballpark as recently as 1989. Watch your maximum retirement savings limit shrink to less than \$1.4 million.

For now, advisors are mulling over two principal questions—who is this going to hit, and how is this going to work?

*“The centerpiece of all this is a lifetime cap on retirement plan savings”*

The president introduced this proposed limit by explaining that it is aimed at the wealthiest Americans, who have saved far more in tax-sheltered vehicles than they would ever realistically need for retirement—recall Mitt Romney's \$100 million IRA.

First, although a very small percentage of Americans have \$3.4 million in retirement savings, significant numbers have at least \$2 million. So as interest rates rise, the number of investors hit by the lifetime limit will rise as well.

Second, investors with large retirement accounts tend to run businesses that employ workers with smaller retirement accounts. If a business owner is prevented from making 401k or other retirement contributions for himself, he has less incentive to pay for and maintain a retirement plan benefitting exclusively the rank and file (who typically are undersaving for retirement as it is).

Enforcing these plan limits would be mind-boggling. It's typical for an investor to have at least an IRA and an active 401k. Add in a 401k or two left at former employers and perhaps a traditional pension—who is responsible for tracking and reporting all those account balances? Who bears the cost for doing so? What if the investor's spouse dies prematurely, naming him the beneficiary on all her retirement plans? As a couple, they could have shared two lifetime limits—is the widower now limited to one? How do IRAs

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**Claire E. Toth, JD, MLT, CFP™**

Claire E. Toth, as Vice President of Point View Wealth Management, Inc., provides our clients with tax, financial, and estate planning expertise, enabling the firm to offer fully integrated asset management and financial planning services. She works with clients on issues ranging from financial planning to estate planning.

Previously, Ms. Toth was Of Counsel to the law firm of Herold and Haines, P.A., in Warren, New Jersey, where her practice focused on tax and business planning for closely held businesses and their owners. Before joining Herold and Haines, Ms. Toth was with the IRS Chief Counsel in Washington.

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## Four Ways to Profit From the Bond Market Selloff

By David G. Dietze, JD, CFA, CFP™

Ben Bernanke's somewhat casual predictions that the Federal Reserve's current \$85 billion a month bond buying program could be tapered off before the end of the year, and terminated sometime next, ignited a firestorm of panic selling of bonds and stocks.

He caveated his remarks by insisting that those predictions were "data dependent," meaning they may or may not occur, depending on how economic conditions develop. Further, three other Federal Reserve bank presidents hastened to mitigate the message; Richard Fisher, alluding to the common analogy of monetary stimulus being a punchbowl at a party, humorously said that no way was it going from "Wild Turkey" to "cold turkey" overnight!

*"Bernanke's predictions that the current \$85 billion a month bond buying program could be tapered off ignited a firestorm of panic selling"*

Nevertheless, many panicked, yanking over \$60 billion from bond funds over the last several weeks. Yield oriented investments of all types were hit hard, including utilities and real estate investment trusts. The stock market pulled back 5% from its highs.

Nobody knows for sure if the latest market ugliness is a foolish tantrum, soon to be forgotten, or the start of something more ominous. What we do know is that some investments are now being offered at far more attractive prices than at the start of quarter, with more generous payouts.

With the return on cash nil and likely to stay that way for the foreseeable future, consider the following as part of a diversified portfolio:

### 1. Discounted Closed End Funds

Many closed end funds (CEFs) contain portfolios of bonds, professionally managed by experienced helmsmen. CEFs differ from open end funds in that the CEF is not required to buy back shares from investors. An investor wishing to sell must trade his shares on the stock exchange.



During the recent selloff buyers were swamped by those wanting out at any price. That left many CEFs at bargain prices; not only had the value of their bonds declined, but the shares' discount to their net asset values widened dramatically.

CEF investors can profit two ways. One is from interest on the bonds and possible appreciation if prices snap back. Second, as panic recedes and investors again eye the superior yields, the discount can shrink.

Consider **MFS InterMarket Income Trust (CMK)**. Yielding over 5%, it has a diversified global portfolio of over 675 bond issues. Its average maturity is a fairly short 7 years; to boost its yield it's modestly leveraged. Its current 11% discount is wider than the 3% that has been seen in the last year. The shares trade 10% below where they stood just 7 weeks ago.

*"Nobody knows for sure if the latest market ugliness is a foolish tantrum or something more ominous"*

Bottom line: CEFs offer a tremendous opportunity to take advantage of recent bond market turmoil.

### 2. Over Sold Exchange Traded Funds

Exchange traded funds (ETFs) are very similar to conventional mutual funds, with two exceptions. First, they trade all day on the stock exchange, as opposed to only at the end. Second, most ETFs have passive, indexed portfolios.

Like CEFs, generally the funds don't make a market in their shares; rather,

trading occurs with other investors on the stock exchange. However, ETFs endeavor to make sure their shares trade as closely as possible to the net asset value of their portfolios. If the share price differs from the internal net per share value of the holdings, large holders can arbitrage the difference by demanding that the fund cash them out with actual securities from the fund.

However, during the recent panic selling, many ETFs either couldn't or wouldn't redeem shares for a portion of their internal holdings. So, ETF prices started to trade at a discount to their net asset values, adding further injury to holders who had already seen their shares drop by 10% or more since April.

*"Closed end funds offer a tremendous opportunity to take advantage of recent bond market turmoil"*

Profit by scooping up these partly discounted ETFs when the shares again trade in line with the actual value of their holdings, plus their holdings bounce back after the selling crisis abates.

Look at **iShares S&P National AMT-Free Muni Bd (MUB)**. This well diversified portfolio of bonds whose interest is exempt from Federal tax lost nearly 10% in the last seven weeks and at one point sported a 3.4% discount to its net asset value. While the fund has since partially bounced back, the current 2.04% yield is the equivalent to a 3.7% taxable yield to a high bracket taxpayer.

Bottom line: The sudden 10% decline in the shares of bond ETFs like MUB makes them attractive.

### 3. Emerging Markets Submerged, But Not Forever

For much of this century the emerging markets have been the place to be, with \$10,000 becoming over \$35,000 as measured by the average mutual fund targeting this area since New Year's Eve, 1999.

Their appeal, led by the so called BRIC countries (Brazil, Russia, India and China),

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## Slow and Steady Wins the Race

By Claire E. Toth, JD, MLT, CFP™

The stock market has now fully recovered from the great recession of 2008-09. Whether an investor can say the same about his own portfolio depends on his behavior during that swoon. Those who stayed the course, maintaining their asset allocations and rebalancing regularly, have recovered along with the markets. Many in that group now feel financially confident and better prepared. Those who panicked at the bottom and sold everything, particularly those who continued to sit on the sidelines and didn't return to stock investing, have a sadder story to tell.

Fidelity Investments studied the retirement accounts of more than 12.3 million investors, focusing on balances and investment returns. Its findings provide reassurance to those who remained invested throughout the past five years.

When it looked as though the financial world was coming to an end, those approaching retirement were particularly concerned. Many in their 50s were financially underprepared for retirement as it was—watching 401k balances drop precipitously caused many to panic. There is plenty of good news for those who stayed the course, particularly those who continued contributing to their 401k plans. The average plan balance among those who have been continuously contributing for at least ten years has increased by 51 percent in the past five. That 51 percent increase



is more or less evenly split between net additional contributions and market return. Indeed, the average annualized market return for this group of pre-retirees is 5.34 percent, on par with the average balanced mutual fund. Thus, the message for those who may have thought retreat was in order is clear—keep doing what you have been doing.

To underline that message, compare these results with those of pre-retiree boomers who sold all their stocks during

the bottom of the market. Those who have yet to return to the market have seen their account balances rise by less than ten percent overall. Those who fled stocks and later returned did somewhat better, but they've only seen their balances rise by about 30 percent overall. The study didn't attempt to compare results for those who returned at different times. Remember—these balance increase numbers include contributions, so the investment return is far less than ten and 30 percent. Bottom line: timing the market doesn't pay.

*"The message for those who may have thought retreat was in order is clear – keep doing what you have been doing"*

If staying the course produced good results for pre-retirees, it produced even better ones for younger workers. Younger workers typically have a higher percentage of equities in their 401ks. Although this meant steeper declines in the last quarter of 2008 and the first quarter of 2009, it also meant a larger increase subsequently. Gen-Xers who stayed invested continuously averaged a 97 percent increase in their account balances, while their younger siblings in Gen Y saw retirement accounts grow a total of 145 percent in the past five years. Again, these numbers take into account both net contributions and market return.

*"There is no single, perfect asset allocation"*  
*"No one can predict the future, but diversifying spreads your bets"*

What are the lessons from all this? Just as market declines and recoveries are nothing new, so is the prescription for preparing for them.

First, have a defined asset allocation. Your asset allocation should allow you both to meet your financial goals and to sleep at night. Be able to define in percentage terms what portion of your portfolio you invest in equities and other risk assets (for growth), in fixed income (for stability), and in cash (for liquidity). There is no single, perfect asset allocation, so don't bog down there. Having a definable asset allocation you can live with is key.

Next, diversify. Morningstar breaks the domestic stock market into eleven different industrial sectors—you should have some level of exposure to all of them. Likewise, your portfolio should include businesses with domestic and international



**Donna St. Amant, MBA**

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## Buffett 2013: The World's Most Successful Investor on Today's Markets

By David G. Dietze, JD, CFA, CFP™

Warren Buffett is indisputably the most successful investor alive today and one of the wealthiest on the planet. His investment vehicle, Berkshire Hathaway, has advanced from \$150 a share in the 1960s to over \$165,000 today. Using Berkshire's book value as the best measure of its worth, it has outperformed the S&P by factor of 7 times; since 1964 it's grown over 586,000 percent versus the S&P's near 8,000 percent advance.

*"What many don't realize is the loss of bond principal that will result if rates rise"*

We can gain insight into his market outlook by piecing together a flurry of news from him this year, including his company's Annual Report, its annual meeting in Omaha, plus his TV appearances immediately following the meeting.

### **Bonds are a "Terrible Investment"**

Mr. Buffett minced no words when it came to the topic of bonds, labeling them "terrible investments" and singling out long term government bonds as especially toxic. Even casual market observers acknowledge that interest rates are close to their lowest in 50 years. What many don't realize is the loss of principal that will result if rates rise. Expect a 6% principal decline for every 1% rise in rates on the 10 year Treasury. That bond yields 1.9% today, but it was nearly 16% in the early 1980s. You do the math.

Interestingly, many believe they have skirted this risk by investing in high yielding fixed income substitutes. But, Mr. Buffett made clear that such investor favorites as junk bonds and real estate investment trusts (REITS) could also deal investors a harsh blow in a rising rate environment.

There's no question that yields on REITS have plummeted, now below 4% compared to 11% in February of 2009, thus offering far less value today. Meanwhile, high yield bonds are, well, no longer high yielding, with their rates below 5% for the first time ever.

Bottom line: Mr. Buffett is warning on bonds, and does not believe that the



popular yield substitutes investors are flocking to today will escape the ultimate fate of longer dated government bonds.

### **Stocks Are "Reasonably Priced"**

Despite being in the fifth year of a bull market, with the Dow and the S&P at all-time highs, Mr. Buffett still thinks stocks are "reasonably priced." Of course, he admits that they aren't the bargains they were several years ago. Nevertheless, in comparison to other investment vehicles, like debt, real estate and farmland, he believes stocks are the best home for your money.

*"Buffett made clear that such investor favorites as junk bonds and REITS could also be dealt a harsh blow"*

That money should have a long term focus; Mr. Buffett says he has no idea where stocks are going in the next day, week, month or even year. His level of confidence only seems to rise when holding periods are a decade or longer.

Bottom line, Mr. Buffett likes equities' present valuations, but recognizes that's no guarantee against a bear market or worse in the near term.

### **Returning Money to Shareholders**

Mr. Buffett continues to extol the virtues of companies' returning money to stockholders, either via stock buybacks or dividends. He responded to questions on **Apple** by relating discussions he had with the late Steve Jobs, counseling Jobs that if he felt Apple's stock was cheap and it had surplus cash, a stock buyback made sense.

Continuing his recurring theme that price is paramount when investing, he warns that companies that buy back stock at too high a price are simply destroying capital. That applies to even great companies; indeed, he made clear that if his own company were to buy back stock at the wrong price that would be a horrendous mistake.

*"Buffett likes equities' present valuations, but recognizes that's no guarantee against a bear market in the near term"*

Mr. Buffett explained in detail why he preferred stock buybacks to dividends. With a stock buyback the holder retains control over when and how much he might want to draw down on his investment by selling shares. This permits tax deferral that's not possible with a dividend.

Bottom line, Mr. Buffett would counsel that after your research has uncovered a cheap stock, the company's plan to buy back stock would increase the attractiveness. Further, despite the current mania for dividends, they are a less efficient way than stock buybacks to build wealth.

### **Hold Some Cash**

Despite Mr. Buffett's long term optimism (Heinz, a recent buy, will be a great brand for the "next 100 years"), a careful parsing of his comments makes a case for keeping some cash in your portfolio.

First, he extolled the advantages of Berkshire's size in the event of a financial crisis, boasting that Berkshire will be the "800 number" because of its cash horde for those caught in the next financial storm. Mr. Buffett suggests there will be plenty of financial panics in the years ahead, and those that have liquidity at those times will profit. Indeed, he cited what a great opportunity his own stock had been during the four times it had dropped 50% "if you had cash then."

Second, while eschewing macroeconomic forecasts, there are

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## Your Shrinking Retirement Plan... *continued from page 3*

inherited from parents figure into all of this? What if a significant market correction takes the account balance below the limit?

*“As interest rates rise, the number of investors hit by the lifetime limit will rise as well”*

Will public employees—including, perhaps, members of Congress—also be subject to the lifetime limit? As states continue to struggle with the cost of supporting retired public employees, many will be eyeing the effect on their own workers.

### Inherited IRAs

Currently, if an individual inherits an IRA from someone other than a spouse (a parent, a sibling, a civil union partner), she is required to take distributions from that IRA over her own individual life expectancy. For adult children of deceased parents, that can range from 25 to 40 years. Because dollars withdrawn from an inherited IRA are typically taxed as ordinary income, this multi-decade withdrawal period can keep investment dollars off the income tax grid for years.

The president's budget proposes to require those individuals to withdraw the entire inherited IRA within five years of the original owner's death. The justification for this is that the heirs aren't relying on the inherited IRA for their own retirement, so the lifetime withdrawal period is unnecessary. Of course, bringing all inherited IRAs into income within five years accelerates the associated income tax.

Two major groups will be adversely affected here. First is IRA beneficiaries who may not be spouses but who do in fact rely on those IRA distributions for support. This group includes not only unmarried couples, but multigenerational families living together, siblings sharing a household, and Golden Girl arrangements. At a minimum, the administration's proposal should be limited to those beneficiaries at least a generation younger than the original IRA owner.

The other group adversely impacted will be young beneficiaries—typically those who lose their parents prematurely. It's costly and time-consuming to manage large sums for minors, who can't legally have investments in their own names. Most young adults aren't equipped to manage large cash inflows for the long

term. Either way, rapid payouts to young IRA beneficiaries will be a net economic drag on the system.

More broadly, the president's focus on the inheritors of wealth as a revenue source should raise red flags. 2013 may be the last best chance to take advantage of Dynasty Trust and Generation Skipping rules. The Generation Skipping Tax was put into place in 1984 and is intended to prevent investors from putting assets into perpetual trusts that escape the estate tax generation after generation. The amount that can be put into these trusts, free of this onerous tax, has traditionally been pegged to the federal estate tax exemption amount—currently \$5.25 million.

*“The president's focus on the inheritors of wealth as a revenue source should raise red flags”*

If the president is willing to go after inherited IRAs, reducing—or eliminating—the amount that can be put into Dynasty Trusts seems a logical next step. Those with significant wealth they want to preserve would be well advised to move sooner rather than later in this direction.

## Four Ways to Profit From the Bond Market Selloff... *continued from page 4*

is that transportation and communication advances are jumpstarting their development. Other factors include a liberalization of their economies with a focus on the private sector, plus a wide disparity between wage rates there versus the developed world.

*“During the recent panic, many ETFs either couldn't or wouldn't redeem shares for a portion of their internal holdings”*

This year, however, these funds have disappointed, down about 10%, starkly underperforming the S&P 500's total return of 11.3%. Much of the weakness is linked to the very same concerns afflicting the bond market, namely that the era

of cheap money is ending abruptly, inciting investors to flee for the now greater returns afforded Stateside.

So, how to exploit? An indexed mutual fund like **Spartan Emerging Markets Index Fund (FPMAX)** offers low cost exposure over 871 holdings. Given the panic selling among ETFs, purchases of **Vanguard FTSE Emerging Markets ETF (VWO)**, whenever its price is pushed below its net asset value, make sense; remember, you're paying 15% less than you would have just six weeks ago.

### 4. Buy Inflation Protection When it's Cheap

There are lots of ways to hedge inflation. Your real estate is one. Equities

generally should appreciate with inflation, with those linked to commodities, like energy and mining stocks, particularly responsive.

Bonds are not generally inflation hedges because, well, the income is fixed. However, the US Government has issued bonds, called Treasury Inflation-Protected Securities (TIPs), which are designed to offset inflation. Basically, the bonds' principal adjusts every 6 months to reflect the consumer price index. In addition, they pay interest. You can measure the latest inflation expectations by comparing the interest on a conventional Treasury versus a TIPs of similar maturity.

TIPs, as a type of bond, were dumped in panic during the recent interest rate

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clearly long term economic problems he worries about. He praises Ben Bernanke and the Federal Reserve for rescuing the global economy in the latest crisis. However, he has no idea how the Federal Reserve will reverse its historic bond buying, and what that may do to the economy.

*“Despite the current mania for dividends, they are a less efficient way than stock buybacks to build wealth”*

Further, he raises real questions on our nation's debt quagmire: “The amount of deficit spending in the last four years ... has been quite appropriate in relation to the threat .....The question is, how do you get off that.”

Bottom line, while Mr. Buffett disdains big picture forecasting, the next crisis is simply a when, not an if, and the prescient investor will have some cash handy to scoop up the inevitable bargains!

### Financials Still Attractive

Mr. Buffett loves brands; one of his biggest holdings is **Coca Cola**. He thinks **Wells Fargo** offers better opportunity today than does Coca Cola. Mr. Buffett underscored the value of its retail depositor basis, a source of long term

cheap funding. Wells' earnings were understated, as it reduced them to reflect the amortization of the value of those deposits; under general accounting rules deposits have a relatively short finite life. But, Mr. Buffett thought those rules understated their life; those deposits are unlikely to leave Wells anytime soon.

*For a fuller version of this article log on to <http://www.ptview.com/files/buffet%20article.pdf>*

## Slow and Steady Wins the Race...continued from page 5

exposure. Not all portions of the economy move in lock step. For instance, when oil prices rise, energy companies benefit and transportation companies feel the pinch; the opposite is true when those prices decline. No one can predict the future, but diversifying spreads your bets and dampens the overall volatility of your portfolio. Owning twenty different stocks isn't diversification if they are all in the same industry. Similarly, your fixed income should be diversified among creditors, including both public and private issues.

**Finally, and perhaps most difficult, rebalance.** In any economic change, some portions of your portfolio will perform better than others. Selling a portion of the top performing positions and investing further in the laggards almost

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back up. Skepticism that inflation is a near term threat has also motivated sales.

There's an ETF which holds an indexed portfolio of TIPs, **iShares Barclays TIPS Bond (TIP)**, that's retreated 10% in just the last seven weeks. That's too much too fast. *For a fuller version of this article log on to <http://www.ptview.com/files/06.28.13%20article.pdf>*

seems counter-intuitive. Why not stick with a winner? However, rebalancing is how you buy low and sell high, avoiding outsized positions and excessive market risk. Investment professionals advise rebalancing regularly, on a set schedule. If a sudden market shift throws your asset allocation out of balance, rebalance again. Consistent, incremental rebalancing reduces your exposure to the bubble and bust cycle.

In a larger context, this all means that markets bounce back. Those with an investment horizon of several years, not several weeks, should stay the course and change their investment plan based on life changes, not short-term market swings.

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