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THIS ISSUE...



# The Fleeting Golden Age of Retirement

by Mike Palmer, CFP®

America's Greatest Generation has lived a life like no other generation in American history. They fought and won the greatest war the world has ever known, returned home and sired the Baby Boom generation, and they've experienced perhaps the most secure retirement any American generation will ever know. After a three decade career with (usually) one company, the average Greatest Generation (GG) worker retired with a comfortable company pension. As a result, most GG pensioners have had the benefits of retirement security largely handled for them. In addition, they've collected, on average, social security benefits in excess of their historical contributions.

The bedrock of the GG's retirement security, the traditional defined benefit (DB) pension plan, is going the way of the dinosaur, replaced with a far less costly defined contribution (DC) plan. In the last two decades, the number of Fortune 100 companies providing DB pension plans has gone from 82 in 1990 to only 16 in 2010. The reduction in DB plans has transferred the responsibility of saving for retirement from the employer to the employee.

Unfortunately, we do a poor job of teaching economic / investment literacy in the United States. A 2006 survey by the Jump$tart Coalition (www.jumpstart.org) found that 65% of respondents (high school seniors) received failing scores on a basic financial literacy test.

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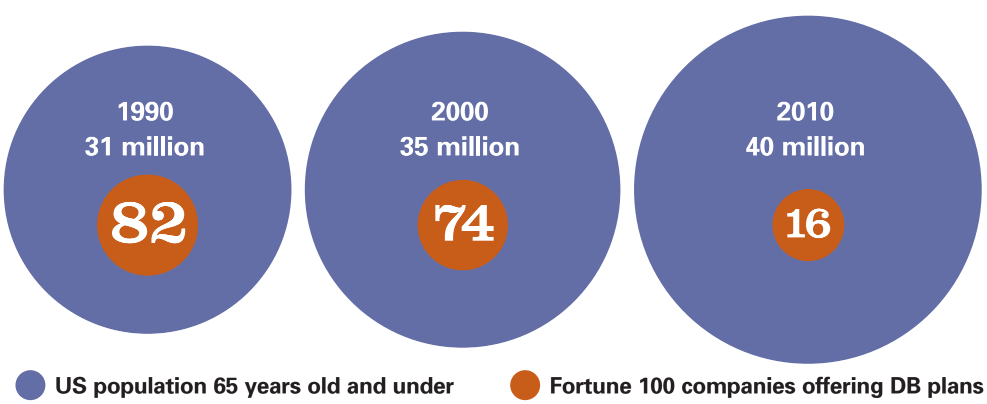


NOTABLE QUOTE

"More money has been lost as result of the four words 'this time is different' than at the point of a gun."

– Ken Rogoff

*Trust Company of the South...because wealth management is more than managing money*

# Volatility or No Volatility?

## Hedge Fund Managers Can't Seem to Decide

by Mike Palmer, CFP®

We were amused to read the July 8 *New York Times* article "Hedge Funds Stalled by Volatile Markets." The article claimed hedge funds were "reeling from the worst second quarter performance in a decade" as they "struggle to figure out where markets are headed." Aaron Garvey, a hedge manager with MKP Capital summed up the general feeling, "for many people, it's a frustrating market given the high volatility and low volumes." Legendary hedge fund investor Barton Biggs echoed this sentiment, "I'm not wildly bearish, but I don't want to have a lot of risk at this point. I'm not putting money into anything, I'm raising cash."

Volatility rewarded disciplined investors during the 3rd quarter as the S&P 500 returned 11% for the quarter, and for the month of September returned 8.8% while the Credit Suisse Alternative Beta index of hedge funds increased a mere 3.6%.

Ironically, in 2007 hedge fund managers were blaming poor performance on the *lack of volatility.* In February of that year Keel Capital, a Connecticut-based hedge fund closed its doors. According to press reports, low stock market volatility and steady gains made it difficult for the firm to find attractive short-selling opportunities. In what could only be described as an embarrassingly bad market call, Keel co-founder Jeff Bernstein said, "short interest is higher and could lead to long periods of lower volatility." Less than 18 months later the S&P 500 suffered three consecutive months of double digit declines.

A June 2007 article in *The Economist* cited an unidentified hedge fund manager as stating "lower volatility is hampering the ability of most hedge funds to generate alpha (excess returns above the market). Higher volatility will enable hedge funds to distinguish themselves."

History offers compelling evidence that making concentrated bets on individual stocks is more likely to result in being blindsided by unpredictable events. Investors are more likely to enjoy a successful investment experience by shunning complex and expensive investment strategies. To quote Leonardo da Vinci, "simplicity is the ultimate sophistication."

## Behind the Scenes at Trust Company of the South

>> **Jay Eich** recently joined the Charlotte Estate Planning Council.

>> **Mike Palmer** attended the DFA Advanced conference in Austin, TX and the inaugural meeting of the DFA national study group.

>> **Will McPherson** was recently elected President-Elect 2011 for the Greensboro Jaycees and will serve as president of the organization in 2012. Congratulations Will!

# The Importance of Fundamentals

by Mike Palmer, CFP®

I just returned from a conference hosted by Dimensional Fund Advisors (www.dfaus.com), a firm that manages money for our clients. The conference featured some of the sharpest minds in finance; Ken French, David Booth, Gene Fama, and Robert Merton are finance's equivalent of "Hall of Famers." But the thing about my annual trek to DFA that really gets me excited is it represents the nexus of high powered pure science (academic finance) and high-powered applied science (astute business people).

Despite the overwhelming brain power in attendance, the conference places an emphasis on basics. Whether it is reviewing the foundation of DFA's investment philosophy or learning how to be a more attentive and effective listener, I always return from this conference a better advisor than when I left. Despite advising clients for two decades, I know I can always improve, and my improvement often begins with a return to the fundamentals.

The benefit of refocusing on fundamentals also extends to our relationships with clients. Modifying investor behavior is an ongoing process, especially in this age of constant media bombardment. It is nearly impossible to turn on a TV or PC and not be overwhelmed with news that is counterproductive to long-term investment behavior. Whether it is the bird flu, global warming, Y2K, the Deepwater Horizon disaster, or the next election, there is always an apocalypse de jour attempting to detour the investor from his or her investment discipline.

By consistently emphasizing that *temporary* volatility (which may last a year or two) is the price of admission for the *permanent* long-term returns of equities, we try to condition our clients to expect the unexpected in the short-term. Large moves in the market, both up and down, often occur without warning and can't be consistently predicted. Repeating these fundamental messages helps insure that our client's behavior doesn't deter their investment performance.

**FOOD FOR THOUGHT**

The enduring strength of capitalism is adaptability, which makes it reasonable to have confidence that problems will be solved without specific knowledge of the mechanics of their solution.

## Irony or Contradiction?

**We were puzzled recently to learn that the Blanche and Julian Robertson Foundation had its endowment portfolio (per the 2008 form 990-PF, a document all public charities must make available as part of their tax exemption) invested in index funds. The foundation was created by Julian Robertson, a native North Carolinian, in memory of his parents. Robertson made his fortune managing Tiger Management Corporation, a legendary hedge fund.**

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Perhaps parents and educators should spend as much time educating our children on financial matters as we do on driving an automobile.

Even more alarming than the financial illiteracy of our young adults is the investing behavior of our nation's savers. According to a recent Wall Street Journal story, 26% of all assets in 401(k) plans as of year-end 2009 were allocated to stable value funds, a year in which the S&P 500 returned 27%. By comparison, in 2008 15% of 401(k) balances were in stable value funds, a year which saw the S&P 500 lose 37%. If there is a truism to investing it is that "the herd" is usually wrong. The old adage that stocks are the only thing that people won't buy when they go on sale is certainly evidenced by mutual fund flows. Confirming the evidence outlined by 401(k) investors referenced above, research by Andrea Frazzini of the University of Chicago indicates mutual fund flows are "dumb money" – they flow to the asset class with the best recent returns, not to the asset class with the better *future* returns.

How can we address a scenario where company provided benefits are ebbing, consumer financial education is an afterthought and investor behavior is more often than not destructive? Is there a way out of the impending retirement tsunami? More robust tax incentives for retirement saving, creating better choice architecture (i.e. forcing employees to opt out of 401(k) enrollment rather than opting in) and requiring some basic financial education in our secondary schools are all steps in the right direction. Another recommendation is to admit we don't know what we don't know. Noted financial author and advisor William Bernstein contends successful investors need four abilities:

- \>\> They must possess an interest in the process. If the task of investing isn't enjoyable, then a poor job inevitably results.
- \>\> Investors require math horsepower. An understanding of the laws of probability and statistics is a must.
- \>\> One must possess a firm grasp of financial history. As our quote of the quarter notes, having a historical perspective enables investors to realize they've seen this movie before.
- \>\> Finally, and most importantly, successful investing requires emotional discipline. The ability to keep one's head when those all about you are losing theirs is perhaps the rarest of investor attributes, for it is a behavior that rarely gets exercised.

Bernstein believes a successful investor must possess all four of these traits, and absent them, suggests individuals would be wise to retain the services of a professional advisor. Having over two decades of dealing with clients of all types, I tend to agree. The golden age of retirement security has sailed. We need to incent solutions that will help the next generation have the same retirement opportunity enjoyed by the Greatest Generation.

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