

# Investing for Retirement

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Unfortunately, there is literally no one I have talked to that has not felt the effects of the economic and market conditions of the past year. People have lost money in the markets, their homes, their wages, and without even really knowing it, the value of their money. It is actually a very tough time to not have a grim outlook on the future. However, when we look at the bigger picture, we have seen times like this in the past. As grim as they feel emotionally, they are also filled with opportunity. As mentioned in our previous newsletter article *The Next 5 Years is Crucial to Your Financial Success*, this is a wonderful opportunity for those with a 10 year or more time horizon. The next 4 to 5 years could be the best investment opportunity seen in stock markets in their lifetime. So what does all this mean for the rest of us? Are we sunk? Or does this environment also create opportunities for us?

While the next 4 to 5 years will provide great long term prices for those younger investors with long term investment horizons, the markets are going to continue to carry extreme volatility. This kind of volatility is not suited for someone in or nearing retirement. You do not want to be trying to take income from a depleted portfolio so you need steady returns. In 2008 this was almost impossible due to severe drops in almost every asset class, but there were a few areas where we were able to stabilize returns and reduce the downside. In 2009 and forward 4 to 5 years it is all going to be about DIVERSIFICATION and waiting for YIELD.

By diversification, I do not mean investing in small and large companies as well as value and growth companies. We have to continue to look for alternative ways to invest that allow your portfolio to look different (have different returns) than the stock and bond markets alone. To do this we look at the correlation of the various investments that make up your portfolio. A correlation of one between two investments means that if one investment rises 1%, the other also rises 1%. Therefore, over the next 4 to 5 years, you need a portfolio of assets that have a low correlation, .70 or less, to the overall stock market (S&P 500) and also have a low correlation to other investments in the portfolio. This will allow for more consistent returns than are available in the stock and bond market alone. Under the best circumstances, depending on net worth, we can invest in some alternative investments that have extremely low correlations to the stock and bond markets.

True diversification, as mentioned above, will help you make it through this period, but YIELD is where the opportunities will lie over the next 5 years.

The government is doing everything in their power (and some things I do not think they should but that is for a different conversation) to inflate the economy. They are lowering rates at the Federal Reserve Discount windows to try and encourage banks to lend; they are also pushing money directly to banks through bailout packages and the new public/private investment fund for “toxic” assets. They passed a huge stimulus bill to try

and create jobs and get more money in the economy. When the government tries to pump money into the economy it takes a while. The government is a big wheel that takes a while to get rolling in one direction. Once it starts rolling fast in that direction, it takes even longer to stop and turn the other way. Therefore, my prediction is the current short term deflationary environment is going to lead to extreme inflation in coming years.

The most recent period we can study that is similar to what I believe we will see in coming years is the 1970's. In the 70's we saw inflation rise quickly a couple of times. In a presentation by Brad DeLong titled "The Inflation of the 1970's", we learn that inflation rose from a little less than 6% in the mid 1970's to over 12% by 1981. What did that mean for investments? Per data from the St. Louis Federal Reserve, you could have purchased a 30 year Treasury bond in 1981 that paid out 14%. If you had purchased these bonds, you would still be making your 14% return through 2011 when the bond matures. Not bad!!!

While we keep a diversified portfolio, we should be patiently waiting and looking for higher yields in coming years. It is already beginning to happen in stocks and corporate bonds. If we are patient, and do not lock ourselves into lower rates (especially not fixed annuities) at current levels, we could see rates that will prove wonderful over long periods of time and aid in what is available for spending in retirement.