

The rational approach to
portfolio management...

STRATEGIC NEWS

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Following simple
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rules can improve
your investment
experience.

Analyst Laszlo Birinyi
argues that past
bear market recovery
patterns indicate we
are in the early stages
of a major bull market.



YOU CAN IMPROVE YOUR INVESTING: JUST TRY MODIFYING YOUR BEHAVIOR

Are you unhappy with your investment returns? If so, here is one of the most important tips you will ever get: It is more likely that your own behavior—not the action in the markets—is getting you down.

Investment markets fluctuate constantly, but investors who stick with balanced portfolios over the years tend to do well. The problem for many investors, though, is being able to stick to a strategy when markets fluctuate wildly in the short term.

For years Dalbar Inc., a major investment research firm, has compared the average returns of stock mutual funds with the actual returns earned by investors in those funds. The long-term results aren't pretty.

Dalbar uses statistics on flows of money into and out of mutual funds to calculate the pitiful average investor returns.



A new year should bring new thinking about your investment decisions. Resolve to change your behavior in 2011.

Behavioral issues

The most recent survey that included returns for the 20 years ended in 2009 showed that the average U.S. stock fund earned 8.2 percent per year. The average stock fund investor, however, earned about 3.2 percent a year.

Why is there such a gap? Investor behavior is to blame, Dalbar says. Investors don't plunk their money down into an indexed U.S. stock fund and leave it alone for 20 years. Instead, they buy and sell, often at the wrong times in the market's cycle.

Resolve to change

The year is still young yet, and you have plenty of time to turn your portfolio management around by using several behavioral modification techniques.

First, look back at your own behavior with honesty. Did you get scared and sell out during the market downturns in 2008, 2002, or 1987? Did you throw money at the tech stock du jour when the market was going up in the late 1990s?

Second, admit that years of sound academic research are correct in concluding that there are no star money managers who will consistently beat the market. You won't find them if you look, so why bother? All you will uncover are those who have done well in the past, but that tells you nothing about the future.

Third, treat the financial news as entertainment. That's really all it is. The networks, the news shows, the magazines and newspapers all are trying to catch your attention in order to get you to look at the advertisements that keep them alive.

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THE WISDOM OF BUY AND HOLD DOES NOT SELL CABLE TELEVISION ADS

(Continued from page 1)

A story that says you should diversify and hold your investments is boring and you will find barely a mention of it in the mass media. Instead they will throw contradictory investment recommendations and economic forecasts at you. Letting any of that influence your investment decisions can easily derail your portfolio.

Fourth, you should resolve to rebalance your portfolio annually.

That will mean selling portions of your recent

winners and reinvesting the money into the laggards.

Finally, you may want to get realistic and admit to yourself that it is the rare person who can go it alone.

Work with an advisor who can put your longings and fears about your portfolio and the markets into perspective and help you sort out the reasons for or against taking precipitous action with your portfolio. Above all, avoid making snap decisions on your own—sit on them for awhile and seek advice.



MARKET HISTORIANS SAY THIS BULL MARKET IS FOR REAL AND WILL LAST

Stock markets worldwide have been rallying for nearly two years now. The Standard & Poor's 500 Index hit a low of 676 on March 9, 2009 and has risen ever since. In late February it was in the 1330 range.

Yet the average investor doesn't seem to trust the trend, and plenty of professionals are skeptical as well.

Worries over the growth in U.S. debt, cynicism over the Federal Reserve's stimulus strategy, and talk of a short-term cyclical bull market within a long-term secular bear market abound.

Yet two of the most eminent historians of Wall Street are saying that not only does this bull market have a long way to go, but that it could be as historic as the market's rise from the early 1980s through the late 1990s.

Wharton's wizard

Jeremy Siegel, the Wharton School professor and author of "Stocks for the Long Run," has studied stock market returns going back to 1802. He says this market is at least 20 percent below the long-term trend line in stocks. Other bull markets have risen well above the long term trend line before they were over, he says.

"This market is not overvalued," he recently told Investment News. "The next several years are going to be good for stocks."

The 2008 bear market pushed the U.S. stock market to almost 40 percent below its trend line. That was the fifth-largest decline since 1865, he said. Such large declines in the past have been followed by strong, multi-year recoveries.

"In 2008, people were telling me that this feels like the 1950s," he said. "But I told them don't lose the faith. Stocks are going to come back."

Strong growth in corporate earnings will propel stocks higher for several years, he argues.

The current estimates for earnings on the S&P 500 say they will surpass the record set in 2007, when the index hit its peak of 1565. Siegel says his analysis indicates the S&P could hit 1800 in the next two years.

Super bull run

Long-time market commentator Laszlo Birinyi has predicted the market could double by late 2013.

Birinyi, a long-time guest on the old Wall Street Week with Louis Rukeyser show, expects the S&P to rise by 60 percent to as much as over 100 percent in the next few years.

Birinyi says his study of past bull markets shows that they go through four phases:

- An initial spurt, when investors remain reluctant to admit a bull market has begun.
- A consolidation phase, when returns are anemic.
- An acceptance phase, when investors start believing and returns begin to improve.
- Finally, an exuberant phase, with strong returns.

He was impressed by the strong 80 percent gain in the first phase of this cycle, and says past bull markets that started out this strong were among the best for investors.

For instance, the bull market that began in 1982 started off with a 63 percent return, he said. By the end of the cycle, stocks had gained 229 percent.

In the end, predictions are educated guesses. Investors should concentrate on sticking with stocks no matter what the short term outlook.



A LESSON FOR YOUNG WORKERS: SAVE AS MUCH AS YOU CAN NOW

Here's a lesson to keep repeating to your children and grandchildren: it's easier to save \$381 per month toward retirement than to save \$5,778 per month.

Seems simple, doesn't it? Yet it might be the hardest financial chore a young person can undertake. The reward, however, is a secure retirement, rather than a decision to keep working or live in poverty.

First, here's where the monthly savings numbers come from:

- A 25-year-old worker who wants to accumulate \$1 million by age 65, and who expects to make 7 percent a year, needs to put away \$381 per month.
- However, the worker who delays retirement saving until age 55 must put away \$5,778 per month—or \$69,336 per year, at age 55 to get to that \$1 million goal.

It's all about compounding of gains, of course: the much longer period a young worker has until retirement

allows his or her savings to grow substantially over the years. In fact, the first \$381 the worker puts away is the most important: It will grow to \$6,215 in 40 years.

Savers who start early get a break later in life: it may be very hard to come up with \$381 per month at age 25, but as they age and inflation and salary increases occur, it will become a snap to put that money away in later years.

In fact, that will free up cash flow in later years to handle the increased expenses of raising and educating children.

Even if a young worker can't save that ideal amount right away, saving as much as possible each month and then regularly increasing that monthly amount will let them achieve their goals. The worst move is to wait until later in life to start saving.



The earlier in life you get started on building a nest egg, the more substantial it will become.



SEEKING THE PERFECT WAVE

New York Times columnist Jeff Sommer, acknowledging recently that he found himself in a “buoyant mood” due to the steady rise in stock prices, sought out someone with a gloomier assessment of the financial markets to provide a counterweight to what he feared could be excessive optimism.

He turned to Robert Prechter, a veteran market analyst who has published *The Elliott Wave Theorist* in Gainesville, Georgia, since 1979. As Mr. Sommer reported last week in the *Times*, Mr. Prechter's investment outlook is “as bleak as an ice storm.” Based on his interpretation of cyclical wave patterns that he discerns in both financial markets and “social moods,” Mr. Prechter believes the current rally is only a minor, upswing within a much larger longer, and punishing downtrend that will “lead the unwary to ruin.”

Market forecasters are often accused of doubletalk, couching their predictions in such convoluted language that they can later claim success regardless of the outcome. At least there is little doubt where Mr. Prechter stands—he sees disaster ahead and has been saying so for quite a long time.

In an earlier interview with the *New York Times* in July 2010, Mr. Prechter suggested the US stock market had

entered a decline of “staggering proportions” that would likely see the Dow Jones Industrial Average—9686 at the time—fall well below 1000 over the next five or six years. Although the Dow has surged over 27% since that time to close at 12391 on February 18, Mr. Prechter is unperturbed and argues that the outlook is “much more dangerous today than it was last summer.”

Perhaps Mr. Prechter will be proven right. But if not, he appears to have ample reserves of both patience and conviction. If his grim vision of deflation and depression sounds familiar, it should—he was making similar arguments in his book *At the Crest of the Tidal Wave*, first published in 1995.

Mr. Prechter has made some prescient market calls in the past—notably in the 1982–1987 bull market—but success since that time has proved more elusive. If only we could determine when to follow the advice of a market soothsayer and when to ignore it, we could be exponentially wealthier. But timing the market timers appears to be no easier than timing the market itself.



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STOCK ANALYSTS PROVE TO BE BAD GUIDES

When you see those ever-confident stock analysts on the financial cable shows talking about why a particular stock will do well, you might want to change the channel quickly.

Analysts seem to do a pretty poor job of predicting which stocks will shine and which will not, according to data compiled by Bloomberg, the big financial news service.

It said that since the U.S. stock market started to recover in March 2009, stocks that analysts didn't like have risen at more than twice the rate as stocks they adored.

S&P winners

Bloomberg sorted the stocks in the Standard & Poor's 500 Index and found that stocks the analysts gave the fewest recommendations to increased by an average of 165 percent, while those the analysts loved rose by an average of 73 percent. One investment advisor quoted by Bloomberg said he likes to invest in stocks the analysts don't like.

You've got a stock that has 15 sells on it, you're set up there to have some strong outperformance," said Don Wordell of RidgeWorth Capital Management Inc. in Atlanta.

During 2010 stock analysts by and large picked health care and technology companies as the most likely to succeed. Instead, those sectors were among the lowest for the year, gaining less than 10 percent on average.

Analysts on average did not recommend banks and real estate firms, yet those industries rose by 19 percent and 28 percent during the year, Bloomberg said.

Bloomberg looked at each individual stock rating by each analyst and assigned a rating number from 1 for sell to 5 for buy. It then looked at the stocks with the most buy and sell ratings. In 2010 the stocks with the most buy ratings gained an average of about 9 percent, while those with the most sell ratings gained an average of 20 percent.

Bloomberg analysts favored health care stocks last year because they did not expect health care reform to pass Congress.

The disaster banks suffered during the 2008 bear market scared enough analysts that they still haven't been recommending bank stocks, even while earnings growth at the banks was accelerating and their stocks were climbing.

Bloomberg noted that analysts are critical of utilities this year and recommend restaurant and retail companies.