# CYPRESS FINANCIAL REVIEW

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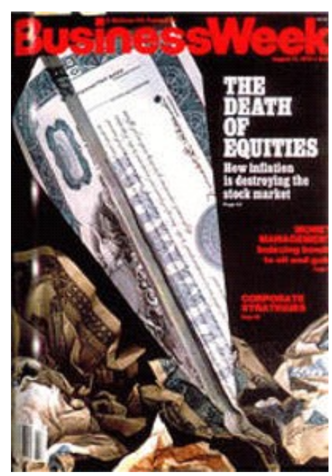
Cypress Financial Planning, LLC

## The Price to Play the Game

I would like to take a step back from the state of affairs to reconsider what it means to be an investor. To begin, consider yourself fortunate if you have surplus savings not needed for bills, as there are many in this world and this country that do not. Various storage places for savings are available, ranging from your mattress to the stock market. It is a commonly held fact that to achieve a higher rate of return, more risk is required. The return part of the axiom is easy to comprehend: it is much better to have an 8% return than a 2% return because at the end of the year $1,000 will be worth $1,080 instead of $1,020. The risk component is a fuzzier concept. The degree of variation in returns and the chances of losing money over short periods of time are high in risky investments.

Two of the broadest investment assets are stocks and bonds. Over very long periods of time, the US stock market has proven to produce an average annual return of 10.2%. Meanwhile, high-quality US Treasury bonds have produced an average annual return of 5.3%. Why do investors place their money in Treasury bonds when past history has shown such an inferior return? It is because over shorter periods of time such as months or years, Treasury bonds have a much more consistent and positive return, i.e. they are less risky. If bonds were just as volatile as stocks, no one would choose to allocate money to bonds because it would not make logical sense: they would provide a lower expected return than stocks with no additional safety. Conversely, if stocks had the same expected return as bonds, no one would choose to allocate money to stocks because they would not be rewarded for the additional volatility they are experiencing.




In 1979, conditions in the US were very similar to our present time. The stock market had been in a rut since peaking many years before. The long-term health of the economy was in serious doubt. In August of that year, BusinessWeek ran a cover story titled: "The Death of Equities" with the thesis that stocks were no longer a compelling choice for future returns. It was consistent with sentiment at that time, and it is arguably consistent with current sentiment. Never before have there been so many fear-inciting advertisements to invest in "safe havens" of gold and CD's to protect from the devastation of the stock market. The great irony about that magazine headline was that the two decades to follow proved to be some of the most prosperous time periods for the stock market in history. The economy runs in cycles and there are a myriad of potential causes for downturns. In the 70's it was rampant inflation, over the past few years it was overleveraged real estate and sovereign debt burdens, in the future it will undoubtedly be something else.

Many individuals overestimate their ability to enhance their rate of return by buying or selling mutual funds in an attempt to correctly "time the market". In theory this seems

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very simple. If the stock market goes up and down, let's sell right before the market goes down and buy right before the market goes up! When the economy looks bleak and the stock market has performed poorly, investors tend to equate this with poor future stock returns and decide now is the time to sell. When conditions are rosy and the stock market is booming, investors tend to conclude that things will continue to go well and pile into stocks as much as they can. Morningstar conducted a study to see how much better off these active, highly skilled investors fared than the "clueless haps" who let their mutual fund holding ebb and flow with the tides of the market. The finding? Astonishingly, the movements into and out of mutual funds actually **detracted** from performance by a factor of about 1.5% annually!

The conclusion of this educational piece is that the decision to own the stock of companies should be made with the understanding that the share price will fluctuate wildly over the time that an investor will own it. An attempt to achieve greater return with less risk by frequently buying and selling funds has proven to be ineffective. Therefore, the price an investor must pay to reap the rewards of higher returns is to subject your portfolio to short term swings in value. Individuals must thoughtfully contemplate how much of a drop they can withstand and not make rash decisions at the wrong times which would only compound the damage. History has shown that an investor who owns stocks for the long term, through the bull markets and bear markets, will be rewarded with a higher average return and a larger portfolio value than someone who did not endure the same level of risk.

## Financial Tips for Thirtysomethings

In our previous edition of the Cypress Financial Review, we began a series on financial advice for each decade of adulthood by laying a strong foundation in your twenties. Upon entering your thirties, it is likely that you have fully embraced the responsibilities of supporting yourself and quite possibly a larger family which could include a few smaller versions of you and your spouse as well as various other creatures. This decade is typically one for an individual or family to place more emphasis on planning for the future. The care-free days of college are a distant memory and the door to retirement is a few steps closer. To ensure that door will be wide open, the following paragraphs summarize the key aspects of your life to prioritize as a thirtysomething.

### Buy a House


With the weak economy persisting, the government has taken extraordinary steps to keep interest rates at historically low levels. Combined with the fact that home prices have dropped more than 32% nationally from their 2006 peak, buying a home right now is extremely affordable. I strongly recommend building a savings high enough to put 20% of the purchase price down on the home to avoid an additional monthly cost called mortgage insurance that lenders would otherwise require. More important, however, is to purchase a home that is within your means. Although a three car garage and a huge master bedroom are very appealing, biting off more than your monthly budget can chew is a recipe for destruction. Ensure your new mortgage balance will not be more than twice your annual household income.

### Pay off Non-Mortgage Debt

In your thirties it is likely that you will still be carrying a debt load incurred from the previous decade. Student loan balances may be greatly reduced but the monthly payments still drag on your cash flow. Coupled with credit card balances and auto loans, there may be a significant chunk of your paycheck going straight to your lending institutions. Make your thirties the decade in which you completely eliminate these debts. Develop a plan to drive down the balances utilizing as much free cash flow as possible. Once a debt is completely paid off, seek to build an emergency fund so that you will not have to rely on lenders ever again. Ultimately, you should be in the driver's seat when purchasing a new car. If a dealership wants your business by giving you 0% financing, you can take it. But if there is no attractive financing available, you will have the ability to cut a check for the full amount.

**Solidify Retirement Planning**

In your twenties you probably attempted to stash away a few bucks in an employer 401(k) or an IRA because your co-workers were all participating and you knew it was the right thing to do. This decade is the time to refine this process and ensure you are on the right track. Between your contributions and any employer match for which you may be eligible, the general rule of thumb is to save 15% of your total income specifically towards retirement. If you take a look at your budget and think that number seems unattainable, then you need to make some major changes and tough decisions about your spending habits. The previous tips of paying off debt and keeping home payments reasonable will significantly assist in freeing up cash flow to hit the 15% number. Ideally, you should rely on more than just a rule-of-thumb to make sure you are saving enough for retirement. A qualified financial planner will utilize a large amount of information regarding your future income and expenses to create a detailed forecast of your capital needs and give you a much more customized analysis of what steps you should be taking to achieve your retirement goals. Most important, you should not wait until the next decade of life to make retirement saving a priority. Savings built in your twenties and thirties has a significant opportunity to grow and build substantial wealth by the time you reach retirement age. Delaying savings until your forties will also delay your retirement.

**Zero in on Career Path**

It is likely that you have been employed by multiple companies at this point in your life. You have gotten your feet wet in a few different industries and you have a better understanding of your business skills and professional style. This decade, you need to make a definitive decision of how you will be spending your remaining working years contributing to society and forge ahead full speed. No one can predict what type of speed bumps will be thrown your way, but you should make every effort possible to choose a career path and develop a plan to reach the position you desire. If you need extra educational credentials, get them as soon as possible. Every year that you delay makes the sacrifice much greater and also makes it more challenging to finish the program.

**Protect Against Unexpected Risks**

A common perception in your twenties is to think that you are invincible. Now that you have a spouse, house and kids, it is time to think seriously about the "what-if's" life may throw your way. If someone else depends on your income, consider a life insurance policy to provide security if you were no longer around. Check with your employer to see how much coverage is available as well as the cost. Term life insurance is relatively cheap. For example, a 33-yr old healthy male can purchase a $750,000 policy with a 20-yr term for a premium of $250 per year.

In addition, you should draft a will with the help of an attorney or an internet program. While many assume that wills are for old, rich people, a will benefits all individuals to ensure wishes are carried out in case of death or if you can no longer make your own medical decisions. A crucial component of a will for young families is that it can designate a guardian to care for children should something happen to both parents. Equally important is to discuss these wishes with the friends or family members who would assume new responsibilities!

**Get Help**

The topics discussed above are difficult for most families to execute in an optimal manner. If you feel as though professional help would serve you well in accomplishing these various financial adjustments, it is highly recommended to engage in the services of a qualified financial planner. Someone in their thirties still has ample time to make needed adjustments to accomplish their longer-term goals. Though as many of us can relate, the hustle and bustle of everyday life makes time pass all too quickly. Thoughtfully consider the recommendations above and set a deadline for making positive changes!

## Third Quarter Financial Review

For those desiring a little perspective on the financial markets, I won't completely disappoint. There is a lot of fear persisting through the stock market which has been reflected in a dismal quarter for investors. For detailed commentary on what events transpired to cause the S&P 500 to drop almost 16% in the previous months, feel free to click here: Wall Street Journal, here: Bloomberg, here: CNBC, here: CNN, or here: Yahoo! Finance.

Some may regret not stashing all of their nest egg into precious metals like gold and silver. You may be surprised to find that these investments aren't quite as "risk free" as the media might make them out to be. Gold is down 16% in under one month and silver has fallen more than 48% since its peak earlier this year.

To offer some direction in the months ahead, I will point you toward one of the more prominent investors of our time. Back in the fall of 2008, during perhaps the scariest part of the financial crisis immediately following the bankruptcy of Lehman Brothers, Warren Buffet penned an Op-Ed in the New York Times titled: "Buy American. I am." In this article, the Oracle of Omaha listed the reasons why he had a strong conviction in owning US companies, and especially strong conviction in buying new shares of these companies at such depressed prices. He followed these words by deploying cash to purchase equities during a time when it was very unpopular to do so. Now that we have the benefit of hindsight, we know that he was slightly early in "calling a bottom" for the market, as a true bottom was not reached until March of the following year. But he was darn close. Buffet feels that the current market selloff presents a very attractive time to pour money **into** stocks, and not the other way around. He recently made a historic $5bn investment in Bank of America, and this past week announced that he would be deploying cash to buyback undervalued shares of his own company Berkshire Hathaway, a move he has never executed in the history of the firm. Again, he is likely not buying at the very bottom of this current market swoon. He is simply not letting his emotions get the best of him, relying on his long-term confidence of the stock market, and buying cheaply. I believe this is an excellent model to follow.