



Panic is Not an Investment Fundamental

Retirement Planning in Volatile Economic Times

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It's August 9, 2011. The Dow is down over 1800 points from its peak. S&P recently downgrades U.S. government debt. What should retirement savers be thinking about?

Recent echoes of the 2008 financial crisis and recession have led to questions about the state of the economy and what, if anything, you should do in response. Here are our thoughts.

We have steadfastly avoided making predictions about the near-term direction of the economy and markets for two reasons. First, such predictions would amount to nothing more than educated guesses. In spite of comments to the contrary from financial media pundits, there is no formula that can forecast with high certainty where the economy or markets will trend in the near term. Second, well-designed retirement plans have an "all-weather" orientation that minimizes the need for an immediate response to market gyrations.

Having said that, an 1800-point plunge in the Dow Jones Industrial Average is unnerving and many people are tempted to change their investment strategy based on their interpretation of current circumstances.

So what is the current state of the global economy? Here are the plusses and minuses as we see them.

Plusses

- Corporate profits have been fabulous. They stand as a line of defense against recession and further market declines.
- Stock valuations were reasonable entering the recent economic rough patch, so there appears to be no bubble in the stock market to blow off.
- Leading economic indicators are still pointing modestly higher. In particular, money supply (M2) is finally showing expansion, indicating there is gas in the economy's tank.
- The Federal Reserve's monetary policy is still very accommodative to economic growth.
- Commodity prices, including oil, have stabilized or fallen.

Minuses

- The U.S. recovery has been unusually weak, so a shock of any type can have an outsized influence on economic activity.
- High energy prices continue to produce a headwind for the global economy.
- The European debt crisis is spreading throughout the Euro zone's southern region. Enormous bailouts appear to have only slowed the process rather than stopping it.
- There is evidence of deceleration in India, Brazil, and China – three recent engines of global economic growth.
- The debt ceiling debate made it clear that the U.S. fiscal condition is dire. Politically unpalatable reforms are needed to fend off further erosion of the domestic economy's foundation.
- Several years will pass before debt levels are reduced to sustainable levels.

Standard & Poor's Downgrades the U.S.

By now, you have been bombarded by media reports of Standard & Poor's downgrade of U.S. Treasury securities from AAA to AA+ with a negative outlook. What is most remarkable about the downgrade is how unremarkable it is. The rating agency provided no new information and no credible analyst was surprised by the downgrade.

Forecasts of higher interest rates in the wake of the downgrade are likely correct but overstated in the near term. Interest rates are set by markets that discount information about the financial soundness of an issuer, and the downgrade simply affirmed what markets already knew about the fiscal condition of the U.S. Ironically, institutional investors might sell lower-quality bonds and buy U.S. Treasury securities to rebalance to their risk budgets, driving yields even lower. Time will tell.

The real impact of the downgrade is likely more abstract. It casts a general pall on the economy that could ultimately self-fulfill as a recession. Time will tell here, as well.

Bottom Line for Retirement Savers

We have reached a period when longer-term structural problems in the global economy are taking their toll on current economic conditions. The light we have watched in the tunnel has always been a train, and it is no longer far down the tracks. Yet the jury is still very much out on whether or not the current rough patch will devolve into a full-blown recession. Indeed, the odds of such a decline remain low.

Under such conditions, retirement savers often attempt to flee risk by selling stocks and buying bonds, and their timing is usually very bad. The downside risks to such a move could be even greater this time around. The relative safety of bonds could be overestimated due to increased correlations with stocks and the long-term potential for rising interest rates and inflation in the wake of an extraordinarily accommodative monetary policy. So extra caution is in order.

Our recommendations to retirement savers have an all-weather theme:

- **Stick to investment fundamentals** – diversification, long-term perspective, risk tolerance evaluation, etc.
- **Don't panic (when the markets are down) or get greedy (when the markets are good).** There is no evidence that even the smartest of investors are able to time the market consistently, so it doesn't make sense for you to try.
- **Review your asset allocation (mix of stocks, bonds and guaranteed dollars).** Make sure they support your investing time horizon, personal risk tolerance and investment goals. For instance, if you are a conservative investor within five years of retirement, you probably should not be invested in 90% stocks. Rather, a more balanced portfolio with an emphasis on safety would be appropriate. Using target date funds may be a helpful strategy for you to achieve proper asset allocation.
- **Keep plugging money into your account.** You cannot control the stock market or interest rates, but you can control how much you save. The amount you save is the single most important determinant to how much you will accumulate for retirement. You may even want to increase your savings levels at times like this.
- **Stick to your plan.** Determine how much you need to save to reach your goals, make sure your investment selections have proper asset allocation and just do it! Do not de-rail your plan because the stock market or economy hits a bumpy stretch.
- **Review your plan.** Take time every year to review your progress and make sure you are on track to meet your goals. Pay attention to your asset allocation and the amount you are currently saving.
- **Contact the Retirement and Investment Solutions Center*** at 800.999.8786, option 3 for help. This dedicated team of retirement professionals is available to help you with just about any topic regarding your retirement.

Now is a good time to re-visit your approach to retirement saving, as times like these tests your ability to stay the course and keep your emotions in check. As always, please let us know how we can help.

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