WEALTH MANAGEMENT

CORE Wealth Management

Winter 2013

"HELPING YOU MAKE SMART CHOICES ABOUT YOUR MONEY"

THE BROCCOLI AND PIZZA PORTFOLIO

Article by Jim Parker

For some of us, it's hard to give up on the idea that investing should be exciting. Picking stocks can be fun, after all, and there's nothing like getting your timing right and bragging about it later with friends. But it's important to separate the concepts of speculation and investing.

For all the accumulated wisdom about asset allocation, risk, diversification, and discipline, some people seem bound to see investing as an end in itself rather than a means to an end.

For these folks, picking stocks is a hobby. They follow the gurus and soak up the financial media. Despite evidence to the contrary, they're convinced they can build a consistently winning strategy by exploiting perceived mistakes in market prices.

Part of the reason is the human tendency toward overconfidence. For instance, we all like to think of ourselves as above-average drivers, when that's simply not possible. Likewise in investing, many of us believe we have powers of foresight not evident in the wider population.

A Duke University study of corporate executives published in 2010 found a dismal record of prediction among a group you might think would do well. Indeed, of 11,600 forecasts for the S&P 500 over nine years, the survey found executives' estimates of future returns and actual outcomes were negatively correlated.[1] *(This is a technical way of saying the executives were hopeless forecasters).*

Photo courtesy of FreeDigitalPhotos.net

Research also suggests the tendency to trade a lot and make confident forecasts about stocks has a gender bias. Whether it's a testosterone-driven instinct among men to boast or something else, study after study shows men find it harder to accept that they are unlikely to "beat" the market.[2]

For these red-meat eaters, an investment approach that advocates working with the market, diversifying around risks related to an expected return, trading efficiently, exercising discipline, and watching fees and taxes is going to sound like the financial equivalent of a broccoli and walnut salad: healthy but boring.

Surely the point of investing is to try hard and, Don Quixote-like, to charge at those market windmills? Are we not men?

There are a couple of ways of confronting this mindset. One is to hope for a change in human nature and persuade each would-be master of the universe to separate his urge for ego

(Continued on page 2)

IN THE NEWS

One of the mutual fund families that we use for investment portfolio construction is Dimensional Fund Advisors (DFA). Their approach to investing is academically based, and you probably have heard some say in the past that Eugene Fama, Sr. who has helped to guide Dimensional in their investment approach for more than three decades, was often thought to be up for a Nobel Prize. Well, this October it finally happened—Eugene Fama was awarded the Nobel Prize in Economics for his work on asset pricing and markets. We are pleased that he has finally received this well-deserved recognition and congratulate him on this achievement.

WHAT'S INSIDE

The Broccoli And Pizza Portfolio (continued)

(Continued from page 1)

gratification from his need to build wealth patiently and efficiently.

This is not impossible, of course. But one suspects it would take some time and would require a lot of face saving.

A second approach is to separate the investment nest egg from the play money. If someone really wants to speculate, he can be allowed to do that with the proviso that long-term retirement money be invested the boring way.

This way, the investor can buy some (expensive) entertainment and accumulate a few war stories to share at his next golf game without compromising the asset allocation painstakingly designed for him and his family.

It's understandable that investing is a kind of a hobby for some people. After all, this is what keeps much of the financial services industry and media in business.

But in separating the concepts of speculation and investing, you can still enjoy the occasional treat while maintaining a balanced diet.

Call it the broccoli and pizza portfolio.

1. Ben-David, Itzhak, John R. Graham, and Campbell R. Harvey, "Managerial Miscalibration," Duke University (June 2010).

2. Barber, B.M., and T. Odean, "Boys Will Be Boys: Gender, Overconfidence and Common Stock Investment," *Quarterly Journal of Economics* 116 (2001).

Dancing On The Ceiling

Article by Jim Parker

Investors have grown weary with the periodic debt showdowns in Washington, each one miraculously resolved at the 11th hour. Some are asking whether they should wait in a safe harbor until "certainty" returns.

In the fourth such showdown between the White House and Congress over public funding in less than three years, the US federal government was shut down for 16 days in October and hundreds of thousands of federal workers were furloughed.

Congress finally came to a deal just one day before the US borrowing authority was due to lapse. The agreement prevented a potential default on US debt. But it provided only another temporary fix, funding the government until January 15, 2014, and raising the debt ceiling only until February 7.

Most people around the world are rightly worried about what the political controversy means for their long-term investments and ability to fund their own retirements.

The answer is that uncertainty is part and parcel of investing. You can never eliminate it simply because no one can ever be sure about the future. Tying your investments to an opinion about the outcome of the US fiscal situation or the euro zone or any other flash point in the news is a recipe for madness.

One advisor in recent weeks had to fend off a client asking whether it made sense to switch a significant proportion of his retirement fund to cash until the situation in Washington "settled down." The downside was slightly lower returns, but this was protection against a potential catastrophe.

The advisor responded by saying that maybe this was a good idea, but would one month be enough? Perhaps the client could wait a year or so. That might be sufficient time for the situation to be resolved. But what if it weren't?

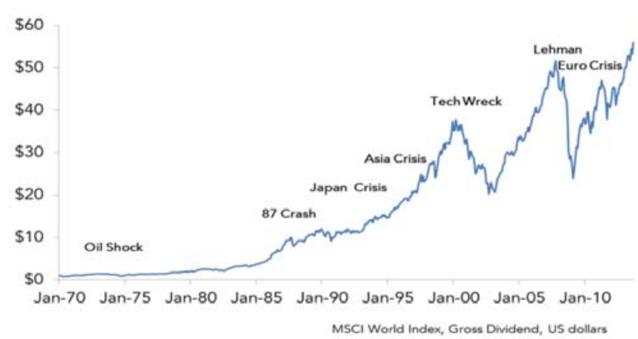
Perhaps, he said, a better idea might be to examine more closely the crises of recent decades and the long-term impact they might have made on his portfolio—such as the oil crisis of 1973, Japan's bust in the early 1990s, the Asian currency crisis of the late '90s, the tech wreck in 2000, and so on.

Without wanting to downplay the real pain that these crises caused—in both financial and human terms—the advisor asked his client what, in retrospect, he could have done to spare himself their worst effects. Beyond, of course, diversifying his portfolio, rebalancing occasionally, and keeping his own long-term needs in mind.

What if he had "waited out" the aftermath of the 1987 Black Monday crash? When would he have gotten back into the market? Was there an obvious re-entry point when Thailand, Indonesia, and South Korea came off their currency pegs in 1997-98? What expertise did he (or his advisor) have that would have gotten that timing right?

(Continued on page 4)

Table 1. WORLD STOCK MARKET (JAN 1970–SEPT 2013)



Past performance is no guarantee of future results. Indices are unavailable for direct investment.

Retirement Hopes Versus Reality

Most Americans (70%) believe they'll have sufficient money to pay their basic retirement living expenses.* Is that your expectation? Before you answer, you may want to take a hard look at some retirement statistics and consider your reality.

• Nearly six out of ten of those surveyed say they currently have less than 25,000 put away for retirement (excluding the value of their primary home and any defined benefit plan benefits)

• 28% report having less than $1,000

• 40% think they will need at least $500,000 in assets to retire *comfortably*

• Another 21% say they'll need between $250,000 and $499,999*

Longevity — another disconnect

Retirement assets should last a lifetime. But when asked how long a person their age and gender can expect to live, 57% of preretirees and 62% of retirees underestimated average longevity.** According to the Social Security Administration:

• A man who turned age 65 in 2012 can expect to live, on average, until age 83

• A woman the same age can expect to live until age 85

• About one out of every four 65-year-olds will live past age 90 and one out of ten past age 95

Connecting hopes and realities

How can you help make your retirement more secure? Start with these steps.

Step 1: Calculate how much income you'll need during retirement. Generally, people who have done a retirement needs calculation are almost twice as likely as those who have not to expect they will need to accumulate a realistically sufficient amount — at least $1 million in the study — before retiring.*

Step 2: Boost retirement contributions. Regularly increase the amount you're deferring to your employer's retirement plan. Whenever you receive a salary increase is a good time to do so. Also contribute to an IRA if you can afford to. You may want to continue to build your regular investment account, as well.

Step 3: Gear investments toward your goals. How you should invest for retirement depends on your personal financial situation and retirement goals. Your financial professional can help you determine your retirement needs and develop an investment strategy to work toward them.

* *2013 Retirement Confidence Survey*, Employee Benefit Research Institute

** *2011 Risk and Process of Retirement Survey Report of Findings*, The Society of Actuaries, 2012 *taxes when all requirements are met.*

Spousal IRA One-Two Punch

Looking for a year-end tax deduction to trim your 2013 income taxes? If you have a stay-at-home spouse, a spousal individual retirement account (IRA) might be just the ticket.

Twofold benefits

You and your spouse can boost the amount you are investing toward retirement and potentially receive a tax deduction for your efforts by contributing to a spousal IRA. For 2013, a married couple can contribute up to $5,500 of earnings to an IRA for each spouse, even if one spouse has little or no earned income. The maximum contribution rises to $6,500 for an individual age 50 or older.

Photo courtesy of FreeDigitalPhotos.net

Deductibility

Contributions to a *traditional* spousal IRA are potentially tax deductible even if you don't itemize your deductions. However, income limits will apply if you (or your spouse) actively participate in an employer's retirement plan.

If you participate in a retirement plan at work and your spouse does not, 2013 contributions to your spouse's traditional IRA are:

• Fully deductible if your modified adjusted gross income (AGI) for the year is $178,000 or less

• Partially deductible with modified AGI between $178,001 and $187,999

• No longer deductible once modified AGI reaches $188,000

Eligibility

To be eligible to make spousal IRA contributions, you must have earned income at least equal to the amount of the contribution(s). For contributions to a traditional IRA, your spouse must be under age 70½ in 2013 (the tax year for which the contribution is made).

Roth spousal IRA

If you're unable to make deductible contributions to a traditional IRA, you may want to contribute to a Roth spousal IRA instead. Roth contributions are not tax deductible. But at retirement, withdrawals from the Roth IRA will be tax free if certain requirements are met. (Withdrawals from traditional IRAs are taxable except to the extent of any nondeductible contributions.) Income limits also apply to Roth contributions.

Talk with us about what type of IRA may be best for you and your spouse. You have until April 15, 2014, to open and fund an IRA for 2013.

Dancing On The Ceiling (continued)

(Continued from page 2)

Back to the present. While newspapers wrote thousands of words and TV stations aired hours of coverage about the latest debt ceiling showdown, many equity markets around the world have reached record or at least multi-year highs.

This is not to assume smooth sailing in the future. But, as investors, we need to acknowledge that living with short-term uncertainty is the price we pay for the premium we receive by putting our long-term capital at risk.

Crises will come and crises will go, as we have seen. Politics is, by definition, about the conflict between different ideas and values. Each of us can have an opinion about likely outcomes. But we can do ourselves a disservice if we base our investment decisions purely on forecasts about politics, economics, or anything else.

Keeping your investment feet grounded in your own life circumstances and needs is preferable to dancing on somebody else's ceiling.

Uncertainty

The media gives you daily doses of negative news to make you anxious about what the future will hold. Congress and the President have a difficult time developing the working relationship that is needed to get the business at hand handled. There are issues with the implementation of Obamacare/The Affordable Health Care Act. The list goes on. The one thing that is certain is uncertainty. This is nothing new.

So far this year, the Market has been investor friendly. However, we know that a downturn is bound to happen sometime in the future. We don't know when it will happen, but it will happen. The process of rebalancing- buying low and selling high- is how we take advantage of such fluctuations in the Market. Rebalancing is much like the old adage- "when life gives you lemons, you make lemonade". These downturns are usually short in duration and will become a faded memory as time passes. At least for now, we will enjoy the uptick in the Market that we have been experiencing.

Our business is based upon relationships cultivated with you—our clients. Many of our client relationships span more than one generation and are important to the success of our business. We are thankful to you for your trust in letting us serve you each day.

We are soon to be right in the middle of the Holiday Season. Take the time during the Holidays to count your blessings, enjoy your family and friends, and make those lasting memories. Thank you for your business. We wish you and your families a Happy Holiday Season!

HAPPY HOLIDAYS!

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors' returns within their tolerance for risk. Here is what sets us apart:

- Fee-only investment management
- A disciplined investment strategy
- Access to institutional no-load passive asset class funds
- An academic Nobel Prize-winning investment approach
- A tax-efficient focus with valuable tax- and estate-planning ideas
- Risk tolerance assessment
- Periodic portfolio rebalancing
- Regular communications and state-of-the-art reporting
- MOST IMPORTANT ... A TRUSTED ADVISOR RELATIONSHIP

CORE Wealth Management

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INTRODUCTIONS—REFERRALS ARE ALWAYS APPRECIATED.