Pettinga Insights and Outlook

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So, You're Ready for Retirement…Or Are You?

In the past, retirement planning used to involve two planning stages: the accumulation of assets, and the distribution of assets. Nowadays, there may be three periods to consider: accumulation, transition, and distribution. "Transition" can be defined as the period between full employment and full retirement when a person is working on a reduced or part-time basis.

What are some reasons to consider working a little longer? Working gives many people a purpose and a sense of self-worth—two benefits that can be more valuable than money in some cases. Working just a few extra years also prolongs the start of the distribution period and enables you to accumulate more savings. This becomes especially important when you consider that life expectancies are rising and you may need to fund a longer retirement than your grandparents, or even parents, did. Continuing to work in the transition years can also provide one additional advantage—it might enable you to receive medical benefits of higher quality than what you would receive as a retiree from your job or from Medicare. This strategy can go a long way in reducing the impact on your portfolio of unforeseen medical bills in early or mid retirement.

Caveat: While we have explored the positives of continuing to work in the transition years, you also need to consider the negatives. One negative is the impact on Social Security benefits. If you decide to start receiving Social Security benefits at age 62, you will be penalized with a reduction in those benefits for any income you receive from working until you reach full retirement age. In addition, Social Security benefits are taxed if you make more than a certain amount each year from earned and investment sources. It may be best to plan this out with your financial advisor to make sure you maximize your benefits.

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Monthly Market Commentary

A repertoire of mixed economic news seemed to be the main theme of July. On the bearish front, employment growth decelerated and construction spending fell. Adding to this sentiment were disappointing pending home sales and weekly shopping growth slowing down to below 2.5%. On the other hand, GDP came out better than expected, and the U.S. manufacturing reports showed stunning improvements.

GDP: The U.S. economy grew 1.7% in the second quarter, a pace that exceeded most expectations. The growth was driven mostly by the consumer, which remains the main engine of the recovery. The biggest surprise, however, was much smaller-than-expected defense-spending cuts that mysteriously stopped in the middle of the sequestration. As a result, government subtracted just 0.1% from the GDP in the second quarter. It is worth noting that the 2012 fourth-quarter GDP was reduced to 0.1% (from 0.4%), and the first-quarter 2013 figure was reduced to 1.1% (from 1.8%).

Employment: The month-to-month numbers for July showed a modest slowing from June. Private-sector employment was slower, hours worked were down, and hourly wages were off. Total job growth for July was 162,000 versus a 12-month average of 188,000 jobs and 189,000 jobs added in June. The culprit in the monthly numbers was slow health-care growth and diminished construction employment. Health-care hiring, a staple of employment growth since the recovery began, has slowed dramatically over the past few months as the Affordable Care Act, and all of its uncertainties, have caused health-care executives to exercise restraint in hiring. The year-over-year trends in employment, however, are virtually unchanged from a month ago. Private-sector employment and hourly wages continue to grow about 2.0%, while hours worked remain virtually unchanged. The unemployment rate in August fell to 7.4% from 7.6% a month before.

Housing: Pending home sales slowed slightly in June, both on a single month-over-month and year-over-year basis. On the home-prices front, an FHFA survey showed year-over-year growth of 7.3% on a single-month basis for the period ended in May—not much different from the April's results. This is in contrast to CoreLogic and S&P/Case-Shiller data that are continuing to accelerate at a pace greater than 12%. While year-over-year price data looks promising, the month-over-month pace looks much worse. It's not at all clear if continued tight lending conditions, a lack of inventory/vacant lots, or higher interest rates are behind the lackluster housing results. Despite those headwinds, however, Morningstar economists predict home-price appreciation between 8%-10% for the full year.

Manufacturing: Manufacturing has been on a plateau for a good part of 2013 as weakening exports weighed on the sector. U.S. demand was no great shakes, either. However, stronger auto and airliner markets have kept the U.S. in positive territory, unlike Europe and China. Morningstar economists surmised that in some month this year, accelerating auto production and faster ramp-up at Boeing would begin to make the manufacturing sector look a little stronger. That month appears to have been July. Both Markit Manufacturing PMI and ISM data showed a marked change for the better with this month's U.S. readings. Markit PMI increased to 53.2 from 51.9 in June, and ISM jumped to 55.4 from 50.9 a month earlier.

Auto: According to Automotive News, auto sales were 15.7 million (which equates to about 15.6 million using the BEA, GDP methodology) for July, off ever so slightly from June's recovery high of close to 16 million units. While the "what have you done for me lately?" crowd wasn't thrilled about the decrease, it is important to note that the pop in June was unusually large. Also, the relatively strong start in July (compared with a not-so-good April) means that the auto industry might be a bigger contributor to GDP growth in the third quarter after showing no gains in the second quarter.

Benefits of Staying Invested Through Market Volatility

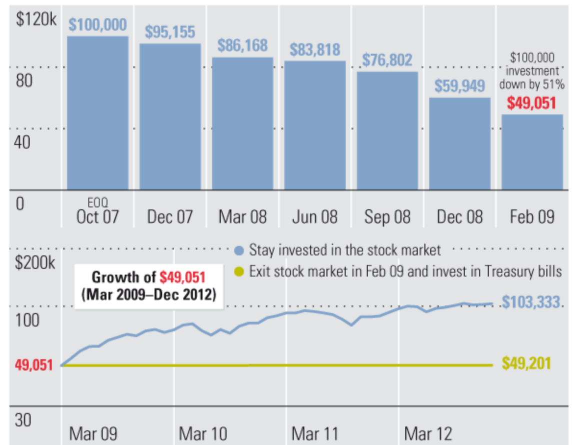
The recent market volatility has investors questioning, “Are stocks still a good investment?” It’s a good question, and one way to address this issue is to look at the recent 2007–2009 market crash. Investors who bailed out of the stock market following the significant decline and moved their money to the safety of cash would be quite disappointed to learn that the stock market, in fact, recovered significantly.

The top image illustrates the value of a $100,000 investment in the stock market at the end of October 2007 (when the downturn began). Over the next several quarters, this $100,000 investment declined significantly, and by February 2009 (the trough date) was down to $49,051, a 51% decline. If an investor panicked and exited the stock market to invest the remainder ($49,051) in Treasury bills (proxy for cash), here’s what would have happened. The bottom graph illustrates the growth of the $49,051 investment in both the stock market and Treasury bills since March 2009. The difference in the ending wealth values of the two investments is considerable. If an investor remained invested in the stock market, the ending value of the investment would be $103,333. If the same investor exited the market at the bottom to invest in Treasury bills, the ending value of the investment would be only $49,201. While exiting the market during a downward spiral may mean avoiding down days, it also means missing days when the market bounces back. While all recoveries may not yield the same results, investors may be well advised to stick with a long-term approach to investing.

The beginning investment time period of October 2007 was chosen to illustrate two concepts: (1) investing right before a significant market downturn and (2) the contrast between exiting the stock market and staying invested during a recovery. The exact timeline of the downturn-recovery is as follows: October 2007 (peak before the downturn), February 2009 (trough), March 2012 (recovery).

Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed. Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest. Stocks are not guaranteed and have been more volatile than bonds or cash. Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss.

Ending Wealth Values After a Market Decline and Recovery



How Much Foreign-Bond Exposure Do You Need?

The European debt crisis took a toll on many world bonds in 2011. The performance of world- and emerging-market bonds may have you wondering how big a role foreign bonds should play in a portfolio, particularly for pre-retirees and retirees. As with most asset-allocation decisions, setting a strategic, long-term allocation to foreign bonds can help you avoid being whipped around by market sentiment. Your decision also depends on where you are in your investing life cycle and on your goals. Younger investors who are in growth mode might look to foreign-currency exposure as a source of diversification. For investors nearing retirement, the bond sleeve of their portfolios may provide stability more than diversification or return-generating potential. A retired investor with a more conservative foreign-bond investment might stake more in such an offering than another retired individual with an investment that's heavy on emerging-market debt. If you have a high weighting in foreign stocks overall, bear in mind that layering on a foreign bond will further subject your portfolio to currency fluctuations.

Diversification does not eliminate the risk of experiencing investment losses. Bonds are subject to credit/default risk, which is the risk associated with the issuer failing to meet its contractual obligations either through a default or credit downgrade. Bonds have varying levels of sensitivity to changes in interest rates. In general, the price of a debt security tends to fall when interest rates rise and rise when interest rates fall. Securities with longer maturities and mortgage securities can be more sensitive to interest rate changes.International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards. Emerging-market investments are riskier than developed-market investments.

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