THE
JENTNER REPORT
Wealth Management Strategies from Jentner Financial Group Winter 2011

STOCK ANALYSTS PROVE TO BE POOR 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 flip the channel. 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 disliked 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 recommended least increased by an average of 165%, while those the analysts loved rose by an average of 73%.

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 out-performance," said Don Wordell of RidgeWorth Capital Management, Inc., in Atlanta.

During 2010 stock analysts largely 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% on average. Analysts on average did not recommend banks and real estate firms, yet those industries rose by 19% and 28%, respectively, during the year.

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%, while those with the most sell ratings gained an average of 20%.

Analysts' least-recommended stocks grew by 165%, their favorites by 73%.

Can we learn from history?

Not expecting health care reform to pass Congress, last year Bloomberg analysts favored health care stocks. Or consider this: 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 banks was accelerating and their stocks were climbing. This year, Bloomberg notes, analysts are critical of utilities and recommend restaurants and retailers. Hmm … can we learn anything from history?

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The President's Word

To improve your investing, try modifying your own behavior

Unhappy with your investment returns? Your own behavior – not market action – may be letting you down. The most recent survey of returns for the 20 years ended in 2009 showed that the average U.S. stock fund earned 8.2% per year. The average stock fund investor, however, earned about 3.2% a year. 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 exactly the wrong times.

The year is still young; resolve to change

First, look honestly at your own behavior. Did you panic and sell out during market downturns? Did you throw money at the tech stock *du jour* in the late 1990s?

Second, admit that years of research have correctly concluded 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, which is useless for the future.

Third, treat financial news as the entertainment it is. A story that says you should diversify and hold your investments is boring and rates no mention in the mass media. Instead you find contradictory recommendations and forecasts that can easily derail your portfolio.

Fourth, resolve to rebalance your portfolio periodically. Sell portions of your recent winners and reinvest the money into the laggards. This will force you to sell high and buy low, better controlling risk.

Finally, you may want to admit that it is the rare person who can go it alone. Work with an advisor who can put the markets into perspective and help you sort out your decisions.

Bruce A. Jentner, President
Jentner Financial Group

Investors shunning stocks sit on fixed-income powder keg

Trauma from huge stock market declines and the financial crisis in 2008 continues to weigh on the portfolios of many individual investors today. Statistics show that many retirement savers yanked money out of stocks and put it into government bonds or bank deposits. Many investors remain fearful of stocks, despite the climb in stock prices that began in March 2009.

However, even though bond investors have been rewarded with capital gains over the last two years as interest rates declined and bond demand held steady, they are now in a potentially bad position, say principals of Tweedy, Browne & Co., a New York investment firm.

"It is quite ironic that in an effort to flee volatile equity markets, investors in high quality low-coupon bonds today sit on a potentially significant risk, should we face inflation and rising interest rates," they write in the company's latest mutual-fund report.

An inflation threat

Yes, stock market volatility can threaten a portfolio, but so can inflation, and too many investors may be discounting its return. Tweedy, Browne notes that the Federal Reserve has said it wants to see more inflation. As The Wall Street Journal notes, "Central bankers who wish for more inflation usually get their wish, and the result is rarely benign."

Even at today's 2% inflation, money is under attack. A thousand dollars today will be worth just $817.07 in 10 years. If inflation goes up to 4%, that $1,000 will be reduced to $664.83. At 6% inflation, it will go to $538.62.

Tweedy, Browne's principals say that low-rate bonds will be big losers in an inflationary environment. They note that some investors call such bonds "certificates of confiscation."

Stockholders, especially those who own dividend-paying stocks, have a much better chance of keeping ahead of inflation. During the high-inflation 1970s, inflation and bond yields virtually matched each other, ranging from 7% in 1975 to 12.4% in 1980. Stocks, however, appreciated at an annualized rate of 17.6% from 1974 through 1980, about twice the rate of inflation.

Weigh sales pitches against sound advice

Equity indexed annuities can be dangerous

The 2008 bear market scared a lot of investors and led to a boom in sales of equity indexed annuities: insurance products with returns linked to the stock market but with minimum guarantees against loss. These annuities appeal to investors who want to participate in the stock market's higher return but dread any decline in the value of their principal.

Sales are strong: in the third quarter of 2010, insurers sold a record $8.7 billion of equity indexed annuities, said market researcher AnnuitySpecs.com. However, a professor in the University of Pennsylvania's Wharton School warns that these products are hard to understand, overpriced and carry long surrender periods.

"These contracts have really high hidden fees," Kent Smetters, professor of insurance, recently told Investment News. "That's why they're terrible ideas for older people even though they're peddled to them."

Agents who sell indexed annuities receive commissions of up to 12% of the sale price, plus other valuable premiums such as expensive vacations. The annuities are usually backed by derivatives, artificial contracts whose value is based on returns in the stock market. The annuities guarantee a holder's principal if held to its term, but that period can be as long as 10 years.

Meanwhile, the return given to investors leaves out the dividends paid on stocks, which accounts for a large portion of long-term stock returns. Insurers are even allowed to lower their caps on annual returns.

Advisors help

A new study says investors who work with professional advisors end up saving two to three times more money for retirement than their peers who go it alone. The Dutch financial firm ING analyzed data from 14,000 customers. About one-third said they spent at least some time with a financial professional; they reported having twice the amount of money as those who say they spent no time with an advisor.

Unprepared to retire

About 75% of middle income households expect to have to work during retirement, while two-thirds say they have not planned for retirement, found a survey of 1,800 households by Wells Fargo. Older workers who think their Social Security benefits are secure, and those who expect to receive pensions, were the most confident about their futures.

Hindenburg is no prophet

Yet another market indicator has failed to tell the future. This time it was the Hindenburg Omen, a technical indicator that tries to predict instability based on the number of new highs and lows on the New York Stock Exchange. Last summer the indicator predicted a pending market crash. Since then the S&P 500 stocks index has risen by more than 20%.

Small stocks beat bonds

Much attention has been paid to how bond returns beat large stock returns over the last decade. But stock investors should not mope: stocks of small companies prospered over the past 10 years. The Center for Research in Securities Prices says small stocks earned 11.5% annually over the 10 years ended last Nov. 30, compared to a 6% annualized return on U.S. Treasury Notes.

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Why do mutual fund investors keep chasing active funds?

Objective mutual-fund performance studies have shown time and again that passive, indexed mutual funds beat their more expensive actively managed cousins. If that is true, why are only about 10% of assets invested in mutual funds put into passive, indexed funds? According to trade group the Investment Company Institute, in its 2010 annual report, the vast majority of individual investors' money has gone into funds that actively pick and choose which investments to buy based on the fund manager's outlook for the economy, the markets, and individual industries and companies.

A poor value

"Given the limited value that these funds seem to offer to their shareholders and the size of the fees they charge, current academic wisdom suggests implementing a simple passive investment strategy based on well-diversified, low-cost fund alternatives," say Sebastian Müller and Martin Weber, two German university professors who researched this question.

Just overconfident

Müller and Weber studied 3,000 mutual fund investors to see if there was any relation between financial literacy and purchases of passive or active mutual funds. They expected that investors with lower financial literacy would be influenced by salespeople and advertising to buy active funds.

They were surprised to find that although financially literate investors were more aware that passive indexed funds were a better deal, the majority continued to put their money into active funds.

"One possible explanation for this result lies in the overconfidence phenomenon," they write. "Investors might overestimate their ability to identify outperforming funds."

Müller and Weber said they found a positive relation between investors' belief in their own ability to identify superior investments and the likelihood that they would buy actively managed funds. But since active funds do not tend to do better than passive funds, these sophisticated investors in essence outsmarted themselves by being overconfident.

The
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"Financial life planning provides better wealth management by asking smarter questions, listening more carefully and applying sound financial and investment strategies to help you achieve personal and objective goals. It is not something different or new; it's simply planning the right way."

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