THE
JENTNER REPORT
Wealth Management Strategies from Jentner Wealth Management Fall 2011

INSIDE THIS ISSUE

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What would happen if the national debt was paid off?

Politicians and voters have heatedly debated this year about the skyrocketing debt owed by our government. Over the last decade the debt has ballooned to nearly $15 trillion. Some taxpayers and politicians have argued that the U.S. should balance the budget and pay down the debt.

Many may have forgotten that just 11 years ago we were on track to pay off the entire debt by 2012. What we didn't know until now was that facing that prospect sent government officials scrambling to put together an emergency plan. Why? Because the U.S. debt – in the form of Treasury bills, bonds, and notes – has been considered the world's risk-free asset and safe haven, serves as the most important interest-rate benchmark, and is used by the Federal Reserve to implement monetary policy.

A potential crisis

In the last year of the Clinton Administration, economists at the Treasury worked on a report speculating on effects of the debt pay down and the investment alternatives that could be used in place of Treasury securities. That report, titled "Life After Debt," never publicly issued, was recently obtained by National Public Radio through a Freedom of Information Act request.

It shows how worried some in the Treasury Department were about the projected debt elimination. U.S. Treasury securities have become a ubiquitous holding for investors, foreign countries, and the Social Security System. There is no clear idea how disruptive the absence of such debt would be.

For instance, where would the Social Security System stash the billions it collects daily from payroll taxes? It needs to earn interest but it also needs a rock-solid security that will guarantee payout later in this century when the retired population increases.

Fed left high and dry

What would the Federal Reserve use to manage monetary policy? Currently the Fed buys and sells Treasury securities in order to increase or decrease the money supply and interest rates. It needs a large, orderly, and very liquid market to achieve its objectives, which is found in the Treasury security market.

The 2000 report proposed alternatives to using U.S. debt. However, in light of what happened during the financial crisis of 2008, such alternative instruments appear to be a lot riskier today than they did when the report was written. The report identified government backed agency securities issued by the giant mortgage companies Fannie Mae and Freddie Mac as alternatives. However, even at that time the market for their securities was not big enough. The agencies went bankrupt in 2008 and limp along today with government aid. The

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The President's Word

Investors should know their real returns

Many investors and most savers probably think about their returns only in "nominal" terms. They only take note of investment yield or return before accounting for inflation. In that view a 2% bond yields 2%. A 6% annual gain on a basket of stocks is a 6% gain.

However, the proceeds of savings and investments are not spent or exchanged in an unchanging world. Every minute, the relative prices of goods and services are changing. In aggregate, prices almost always go up over time. That's called inflation.

The silent killer

Inflation is the silent enemy of anyone who is trying to accumulate capital. It eats away at value and can turn even a "safe" investment into a wealth destroyer.

Investors these days have two hurdles: a volatile stock market that has had sharp drops over the past five years, and a very low interest rate environment that has pushed yields at banks and money market funds close to zero.

A slow decline

The market's roller coaster ride has caused many investors to pull money from portfolios and put it into cash holdings. Those hunkering down in cash or money market funds may think they are protecting their nest eggs, but with consumer inflation running at over 3%, savers have actually been losing money that they thought was safe from the stock market's volatility.

Loss can come from the effects of inflation on the purchasing power of cash, and from lack of opportunity to profit in the stock market when investors delay reinvesting their money. In either case, investors ultimately may lose wealth even as they try to protect it.

We believe the better alternative is to diversify in a balanced portfolio. Safe havens are difficult to find, market timing is difficult, and concentrated portfolios are too risky.

Bruce A. Jentner, President
Jentner Wealth Management

"national debt"

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swaps market, where banks and other institutions swap liabilities, was also identified as an alternative because it was "remarkably liquid" and a "vibrant market." However, that market froze solid in 2008 and has yet not fully recovered.

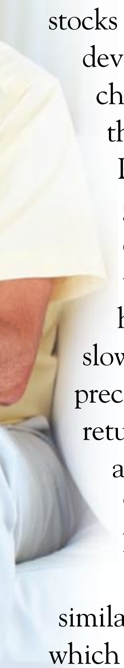
The report showed that, even though our debt is too large now, there may be virtue in always having some amount of U.S. government debt outstanding as a backstop for world markets.

The last eleven years have been a challenge

Do you feel like you aren't making money on your investments and savings the way you used to? You aren't alone and your perceptions are not off. Since the start of this century, returns on most investment and savings vehicles have been well below long-term averages, and markedly lower than they were from 1980 through 1999.

Investors and savers have earned subpar returns since the first day of 2000 and it is hard to see a pickup coming soon. The outlook for savers is especially bad: the Federal Reserve's pledge to keep short-term rates at nearly zero for the next two years will mean that there will be no pickup in rates paid on bank savings, money market funds, or U.S. Treasury securities.

Hope for investors



However, it pays to take the decade-wide view. Investors who own big stocks in the United States or the developed world have had little to cheer about recently: from 2000 through 2010 the Standard & Poor's 500 Stocks Average gained just 0.4% per year on a compounded basis. Investors with diversified portfolios still have plenty to hope for, as such slow periods in the past have always preceded years with above-average returns. The S&P 500's long term average (since 1926) has been 9.9% per year, while in 1980-1999 it gained 17.9% per year.

The last decade's results are similar to the Great Depression, in which S&P 500 lost 1% yearly from 1930 through 1940. But each decade from 1940 through 1999 offered positive returns on stocks, until this century, which (as in 1929-1932 and 1937-1942) has suffered so far through two major bear markets.

Unhappy savers

Those who like to sock all their money away in the bank are unlikely to enjoy any real return over the next few years and may lose purchasing power. Average rates in savings accounts and certificates of deposit currently are less than 0.2% per year. The Fed says that's where they will stay into 2013. Meanwhile, consumer inflation is averaging over 3½%, so savers actually lost money by keeping it in the bank. To add insult to injury, many paid income taxes on their meager interest.

Diversification works

The market's behavior since the Depression offers hope to today's investors that stock returns could pick up over the next decade. Diversified investors can also take heart knowing that they probably did better than the S&P 500 over the last 11 years and have a good chance of doing well going forward. After all, there have been winners since 2000: small U.S. stocks gained 7.4% a year, real estate investment trusts 12.1% per year, commodities 8% per year, and emerging markets stocks 10.9% per year.

A balanced, diversified portfolio provides an opportunity to earn meaningful returns over time. By using periodic rebalancing to take advantage of market fluctuations, the disciplined investor has been able to earn a positive return over the past 11 years in spite of low interest rates and high stock market volatility.

Financial frauds grow during hard times

Con artists come out of the woodwork during times of economic and market stress, preying on investors looking for better returns or alternatives, says the North American Securities Administrators Association. State officials who regulate securities have seen a host of new scams aimed at those looking for alternatives to low bank interest rates and a volatile stock market.

"Con artists follow the news and seek ways to exploit the headlines to their advantage while leaving investors holding an empty bag," said Association president David Massey. The current top five financial products designed to trap unwary investors:

- Distressed real estate schemes that offer investment in foreclosed homes.
- Energy investments like the one that touts "wave energy."
- Gold and precious metals investments, often linked to promises to mine gold from dormant claims.
- Promissory notes that "guarantee" high interest rates on privately placed loans.
- Securitized life settlement contracts, where an investor "buys" the death benefit of someone's life insurance policy and the results are "guaranteed" by bonds.

"Unsuspecting investors can be lured into these schemes, especially if they sound familiar," Massey said. "These offerings require careful research and a strong reminder that if it sounds too good to be true, it probably is not true, nor will it be profitable to anyone but the promoter."

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Bond investors have been winning, but can the streak continue?

Government bonds have been standout investments since 2000 as a combination of falling interest rates and roiled stock markets sent investors fleeing for their perceived safe haven. But investors hoping for a repeat of this performance in the years ahead may be sorely disappointed. At best, bonds may underperform stocks and earn returns of a couple of percent a year. At worst, they will lose value if inflation increases, says a report issued by the Research Institute of Credit Suisse, a global banking company.

"Only a raging optimist would believe that, given today's bond yields, the future can resemble the more recent past," the Institute's 2011 Investment Returns Yearbook said. "It is sheer fantasy to expect bond performance to match the period since 1982."

A long bull market

Since 2000, bonds have beaten stocks in 15 of 19 developed countries as interest rates declined over the period to historic lows, boosting bond prices. "Government bonds have so far tended to be the asset of choice in the 21st century," Credit Suisse said.

Despite that, stocks have handily outperformed bonds over the past 111 years in the 20 developed markets tracked by the bank. In the United States, for example, inflation-adjusted annual returns for stocks over that period were 6.3% a year, compared to 1.8% for government bonds.

Long bear markets

Even though bonds have done very well since 1982, they have gone through several major bear markets since 1900. Credit Suisse put together charts of bond performance in England and the United States over the last 111 years.

"For those who are seeking safety of real returns, these charts are devastating," it said. "Historically, bond market draw downs have been larger and/or longer than for equities."

The worst period was in the U.S., when bonds hit their peak at the end of 1940, declined by 67%, and did not recover until mid 1991. Inflation governs future bond returns. If higher inflation reappears, Credit Suisse says bonds will become riskier and lose value.

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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."