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It's Tough to Make Predictions...Especially About the Future

by Matthew P. King, CFA, Managing Director, Chief Investment Officer

The start of a new year often leads me to reflect on my life and the progress I have made personally and professionally over the previous twelve months. But, with the start of a new decade (yes, I realize there was no Year Zero), I found myself being even more reminiscent than usual as I looked back on the course of my life over the past ten years. At the start of the 2000s, zeros, aughts, or whatever the parlance of future generations will anoint this past decade as, I had not even begun my career with Bell Investment Advisors. In fact, I was working for a small business accountant in San Luis Obispo, California. Ten years certainly passes quickly as that time in my life seems like eons ago.

The recollection of my previous employer immediately made me think of a conversation that my then boss and I had just about ten years ago. We were on our way to a client's office, and we were listening to business news on the radio as we drove. The report that sparked our conversation was that, for the second year in a row, the Federal government projected a budget surplus in 1999, the first consecutive years of surplus since 1956–1957. The reporter then opined that if these sizable surpluses continued, it was conceivable that the national debt could be retired in our lifetime. Upon hearing that, my boss asked what I thought the financial markets would use as the risk-free asset if there was no longer any debt issued by the U.S. Treasury. I suggested that the debt of government-sponsored enterprises like Fannie Mae and Freddie Mac would fill the void left by Treasuries because they were nearly as safe given that they were implicitly guaranteed by the Federal government.

I think my mind recalled this conversation because it sounds so ridiculous now, and my amygdala knows that I find irony to be quite humorous. But, there is more to take away from this anecdote than just a good laugh; there also exists an important investment lesson here. Ten years ago, it was actually conceivable that the national debt could be paid off during our lifetime, and the possibility that Treasury debt may not be around to serve as the risk-free asset was a legitimate concern. Fast forward ten years later. Now, we are running record budget deficits in the trillions of dollars, and the national debt is rapidly growing with no signs of slowing down. Today, if I used the front page of this newsletter to discuss potential replacements for the risk-free asset once Treasury debt was completely retired, you would justifiably think I was crazy.

That is the problem with predicting the future; it is completely unpredictable. Our view of the future tends to rely on historical data and an extrapolation of present events. Extrapolation proves problematic because things change, sometimes dramatically. As the last decade began, who would have thought amidst a booming economy and burgeoning budget surpluses that the Federal government would be running trillion dollar deficits just ten years later? Who could have predicted that the seemingly safe debt issued by Fannie Mae and Freddie Mac, which was then implicitly guaranteed by the Treasury, would eventually be *explicitly* guaranteed after the government was forced to rescue both companies from bankruptcy?

Using history as a guide often fails because occasionally the entire paradigm shifts, leaving us with no frame of reference. No historical precedent exists to understand the effects and consequences of a worldwide economic slowdown and the subsequent coordinated efforts among governments to provide massive amounts of financial stimulus. An integrated, global economy is a relatively new phenomenon, and the scale of current fiscal and monetary stimulus packages has never been seen before.

Despite their obvious perils, prognostication and forecasting have unfortunately become the key driver of asset allocation for many investors. Project what the future will look like; determine which asset classes, industries, and countries will benefit; invest accordingly. The problem with this approach to investing is that the future is not knowable, and investing based on what is not knowable is not really investing at all—it is speculation.

Regrettably, this mentality towards investing is encouraged by our industry and the financial media. This time of year business magazines publish their annual "How to Invest in the Coming Year" editions. CNBC fills much of its air time with experts telling you where the market and economy are headed. Even as I was typing this, I received an email invite to my professional society's Annual Forecast Dinner. As a result of this conditioning, the most frequent question I am asked when it is learned that I invest professionally is, "Where do you think the market/economy is headed?"

To be successful investors and proper stewards of our clients' assets, we accept that we do not and cannot know what the future holds. Therefore, we have always utilized a completely agnostic strategy based on performance momentum that adapts to changing market and economic conditions. We do not forecast where the market will be at year end nor what the global economy will look like in ten years. Instead, we closely watch the inherent trends in the global financial markets. As trends and conditions change, we change with them without interference or bias from previous forecasts.

Presently, with economic uncertainty and regulatory risk running high, combined with the unknown lasting effects of increasing government intervention and unprecedented amounts of stimulus, we believe that our agnostic, adaptive strategy holds more value now than ever before. If any environment lent itself to successful long-range prognosticating, it is certainly not the present one with the economy and financial markets in uncharted waters in many respects. ■

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Account Performance Report through December 31, 2009

Since 1999 we have calculated the average and median returns of our clients' accounts. These performance figures are derived from actual accounts managed by Bell Investment Advisors. Here is a quick look at the latest results:

Matthew P. King, CFA

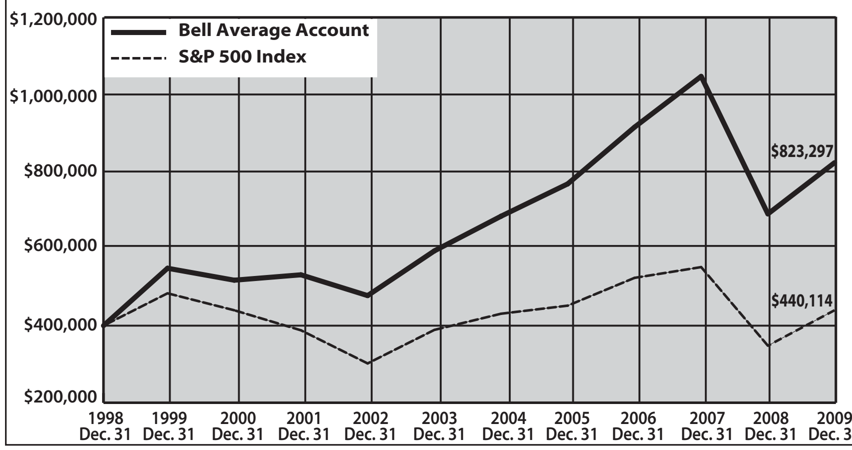
This table compares our average and median account performance compared to five of the major market indices. While you cannot invest directly in any of the indices listed above, it is interesting to note that the most popular index, the S&P 500—with $915 billion indexed to it—gained just 10% since the start of 1999.

	2009	January 1999 to December 2009	
Index	Year-to-Date	Total Return	Annualized Return
Bell Average Account (1)	19.4%	105.8%	6.8%
Bell Median Account (1)	19.6%	104.0%	6.7%
Dow Jones Industrial Average (2)	22.7%	44.7%	3.4%
S&P 500 Index (2)	26.5%	10.0%	0.9%
Nasdaq Composite (2)	43.9%	3.5%	0.3%
Russell 2000 Small Cap Index (2)	27.2%	71.3%	5.0%
MSCI EAFE Index (2)	32.5%	48.9%	3.7%

Meanwhile, our Active Portfolio Enhancement® methodology has more than doubled our clients' assets since 1999. Our advantage lies in our proactive, momentum-based approach versus the passive strategy of tracking a particular market index.

When you compare performance results, it is important to make note of what is, and is not, included in the stated returns. Our returns are reported net of all management fees, mutual fund expenses, and trading costs. Here, the bottom line is the bottom line.

Growth of $400,000: Bell Average Account vs. S&P 500 Index



You have seen our performance in terms of percentage return. Here is how our average account performance since 1999 compares to the S&P 500 Index in dollars and cents. The graph above shows the growth of a hypothetical $400,000 investment made in January 1999. ■

Notes: (1) These accounts include the effects of Bell's management fee, mutual fund expenses, Schwab transaction fees, short-term redemption fees, and cash holdings. (2) These returns do not include the effects of the items described in Note 1.

Disclosures:

Past performance is no guarantee of future results. Future returns may differ significantly due to materially different economic and market conditions. Returns assume the reinvestment of dividends and capital gain distributions. These investments involve risk and the possibility of loss—including principal. Mention of a security in this newsletter should not be taken as advice to buy or sell that security.

In regard to the Bell Average Account, the term "average" is defined as a simple average—not a weighted average. Only fee-paying clients who fully employ our Active Portfolio Enhancement strategy are included in the return calculation. Client accounts that hold individual securities or funds not recommended by Bell; employ fixed income, hedging, cash reserve, market timing, socially responsible, or any other strategy not representative of Active Portfolio Enhancement; or maintain cash allocations greater than ten percent of the portfolio are not included in the calculation. We believe that removing these accounts improves the stated results as Active Portfolio Enhancement has traditionally been our most successful strategy. Additionally, only client accounts that were managed for the full calendar year are included in that year's return calculation. Accounts opened mid-year are not included in that specific year's reported results. We do not believe this policy has any material effect on the stated results.

The "Growth of $400,000" graph represents a hypothetical investment of $400,000 made at the end of trading on December 31, 1998, and is based on the returns produced by the average Bell account and the S&P 500 Index, neither of which can be invested in directly.

The S&P 500 Index is an unmanaged, market-cap weighted index of large-cap stocks commonly used to represent the U.S. stock market. More information can be found at www.standardandpoors.com. The Dow Jones Industrial Average is an unmanaged, price-weighted index of 30 large-cap stocks. More information can be found at www.dowjones.com. The Nasdaq Composite is an unmanaged, market-cap weighted index of all-cap stocks listed on the Nasdaq Stock Market. More information can be found at www.nasdaq.com. The Russell 2000 Index is an unmanaged, market-cap weighted index of small-cap stocks. More information can be found at www.russell.com. The MSCI EAFE Index is an unmanaged, unhedged, market-cap weighted index of foreign stocks commonly used to represent developed stock markets outside the United States. More information can be found at www.mscibarra.com. None of these indices can be invested in directly. The composition and volatility of Bell's client accounts vary and may significantly deviate from these indices over time. ■

PREDICTING VS. PLANNING by Bonnie Bell, Career & Life Coach

Right on the heals of all the "Happy New Year" greetings in January come the inevitable predictions about the future on just about every topic imaginable. It is an ancient phenomenon, this deep human desire to know what is going to happen before it happens—an attempt to gain power over fear, I suppose.

Mere "predictions" are not really what people want; they want foreknowledge, certainty. They want to *know* what is going to happen, which is why throughout history there has never been a shortage of psychics, fortune tellers, or other soothsayers. If you want to talk to one today, you can probably find one in your own neighborhood, and if you don't happen to know where there is one close to you, hundreds of them await your internet search.

Ironically, along side this age-old desire to know what is going to happen before it happens, is an opposite tendency for people to deny or ignore the actual facts that surround them and take tremendous risks instead. While people want certainty about the future, they are willing to gamble on a daily basis with their money, and in one way or another, their health and their lives.

Life is hard, and we are complex, perplexing creatures. So let's cut to the chase. Here is a certain prediction you can base your life on: some good things are going to happen, and some bad things are going to happen. Now what?

Planning for the future and predicting the future are two very different things, but most definitely connected. It is precisely because we cannot predict the future with certainty that we need to plan for it. Without a plan, at best we are just holding our breath and crossing our fingers that it will all somehow work out; at worst, we are playing a dangerous version of Russian Roulette.

At Bell we care about the quality of people's lives, not just the quantity of their assets. We believe that a "good life"—whatever you say that is—is what most people want, but we also know from experience that wanting a good life and making it happen are two different things. It's definitely not magic. But it's not impossible either.

This is why in addition to Investment Management Services, we offer comprehensive Financial Planning and Career & Life Coaching as well. We also offer a combination package that includes a Retirement Outlook, which specifies the probability of success of your various retirement goals, and a series of Life Coaching appointments to help you gain clarity about what you say a good life is or would be for you, and then to help you develop an actionable Plan you can begin working on today to get to where you say you want to go in the future. Basically, the elements that add up to a "good life" include the following:

- **what you do**—your work
- **where you live**—your geographical location and living space
- **who you are with**—your partner or not, your family, friends, community
- **what you care about**—living your values
- **what you want**—now and in the future
- **what you love**—making sure you incorporate the activities you love, and
- **how much money you will need to make it all happen.**

I recently completed work on one such Making a Good Life Happen[SM] package with one of our Investment Management clients. She is in her middle-fifties, working in a high-powered position, and was worried about the future. Especially in light of the market downturn, she was not sure if she would be able to afford to retire any time soon, and if so, what would she want to do next?

Now she has answers rather than just questions. She tells me she is not only sleeping better, but excited about her future. She knows when she is going to retire—age 58; how much money she will have to live on (under $100K per year); and she has a Life Plan to guide her actions beginning NOW. For her, that includes taking a graduate level class in the subject she loves most, in the field she will pursue following retirement. She may continue to work in her current field as a consultant if she wants to earn additional income, but she will not have to. She is already involved in several activities she loves, but has plans for doing more of that in the future.

Will some good things and some bad things happen in her life? *Yes.* Will she implement every detail of her Life Plan and bring it to perfection? *Probably not.* Will she win the lottery? *Who knows?* Will she "meet someone"? *Who knows?* These are not the things we can know for certain. But with clear thinking about who she is, what she wants, and a Life Plan in hand to guide her toward the future she wants, I think we can bet that she will have a pretty good life.

Please feel free to call me to inquire about any of our planning offers. We can always arrange for a free consultation to discuss the details. ■

Bonnie Bell, MA, M.Div.

THE IMPORTANCE OF PERSISTENT SAVING AND INVESTING by Jim Bell, CFP®

James F. Bell, CFP®

By now, everyone must have seen numerous references to the Lost Decade in the financial media. The ten years just ending have been the worst decade for U.S. stocks in modern times, even worse than the decade of the Great Depression in the 1930's.

From 2000 to 2009, the S&P 500 Index, which is made up of 500 of the largest U.S. publicly traded corporations, fell by 9.1% including reinvested dividends. The S&P 500 was not in existence in the 1930's, but as a substitute, Ibbotson Associates reports that large cap stocks were down 0.5% including reinvested dividends in the 1930's, so the decade just ended was actually worse in regard to large-cap stock investment returns than the decade that housed the Great Depression.

Let's put this in perspective though. The term "Lost Decade" assumes that you started with a fixed balance on January 1, 2000 and did not save or invest anything for the next ten years. For example, an investor who simply invested in a global portfolio of 80% Vanguard 500 Index Fund and 20% Vanguard Total International Stock Index Fund lost 3% over the course of the decade. However, an investor who started with $10,000 in that same allocation but invested $1,000 per month in the portfolio split 80/20 between the two funds actually made money during the decade—over $15,400 for a return of 12%.

While these returns are nothing to write home about, the Lost Decade proved much worse for investors who gave up on their investments completely by selling at or near the bear market lows of October 2002 and March 2009.

Conclusion: it was not a Lost Decade for investors who stayed true to their investment plan through thick and thin and did not succumb to fear by halting their regular investment schedule or going to cash.

A 401(k) plan structure helps participants to become persistent investors by allocating dollars from every payroll as long as the participants don't lose their way, stop contributing, or try to time the market. Automatically reinvesting your dividends and capital gain distributions accomplishes the same thing.

Even in the Lost Decade—which could not have been predicted—the disciplined practice of saving and investing regularly turned out to be a sound strategy, producing gains in a difficult environment.

To learn more about our investment strategies and financial planning offers, please contact us to arrange a complementary consultation. ■

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