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## What a Long, Strange Trip It's Been

By Sheldon McFarland, VP, Portfolio Strategy & Research, Loring Ward

It's hard to believe that with all the headlines, the Dow Jones Industrial Average (Dow) is up almost 7% for 2011 (through 12/1/11).\*

Imagine you had a crystal ball on December 31, 2010 and could foresee all of the major events that would happen over the next twelve months: Earthquake, tsunami and nuclear reactor leak in Japan, uprisings and civil war in the Middle East, the debt downgrade of the United States, the bankruptcy of our nation's third largest airline, fears that the euro would collapse due to Greek debt woes.

Would you have wanted your money invested in the stock market while all this was going on?

There's a good chance your answer would be "no."

But would you have changed your mind if that crystal ball also told you that the Dow would have its best month in nine years in October 2011, and that most of the major U.S. market indices were flat or positive for the year (through 12/1/11)?\*

Because none of us have crystal balls, we don't know what's in store for 2012. However, let's look at what we *do* know.

### Volatility

It's true that volatility has increased. The daily volatility of the Dow increased 17.7% this year over rolling 10-year periods since 1988.\* However, the monthly volatility for the same time period is right in line with historical averages. What does that mean for investors? Focus more on the long term and less on the short term. In spite of the volatility, the stock market — as measured by the Dow — has averaged 15% per year since 1988.\*

### International Performance

Diversification can be your friend. Although there is no guarantee that they will always perform as well as, or better than, U.S. stocks, including stocks of international companies in your portfolio is a great way to reduce — potentially — your portfolio's risk. There are years, like 2011, when the stocks of international companies can significantly underperform the stocks of U.S. companies. But that doesn't mean that you



## Putting Volatility in Perspective

By Matthew Carvalho, *Director, Investment Research, Loring Ward*

Volatility is often an investor's worst enemy. During those periods when the markets are down 10, 20, 30% or more, our natural instincts tell us to run for cover. And there will always be reasons to be fearful. Looking back over history we can see numerous stories which would have made investors fear the worst.

In the 30s and 40s we had the Great Depression followed by a horrendous World War. When the War ended in 1945, the top tax rate at the time was 94% — not very investor friendly. In the 50s we had the Korean War, followed shortly by the start of the Vietnam War. The 60s began with the Cuban Missile Crisis, followed by the assassination of a President and the expansion of the Vietnam War. The 70s were characterized by an oil shock, stagflation and “malaise.” In 1980 we still had high top tax rates of 70%, while inflation stood at 13.5%. Later in the decade we had the Savings and Loan Crisis, followed by the Black Monday Stock Market Crash of 1987 which wiped away 23% of market value in a single day. The 90s saw great returns, but contained their own fearful moments with the Mexican Peso Crisis, the Asian Financial Crisis and the Long Term Capital Management blowup in 1998. We all are well aware of the risks we faced in the 2000s, as many investors experienced a lost decade.

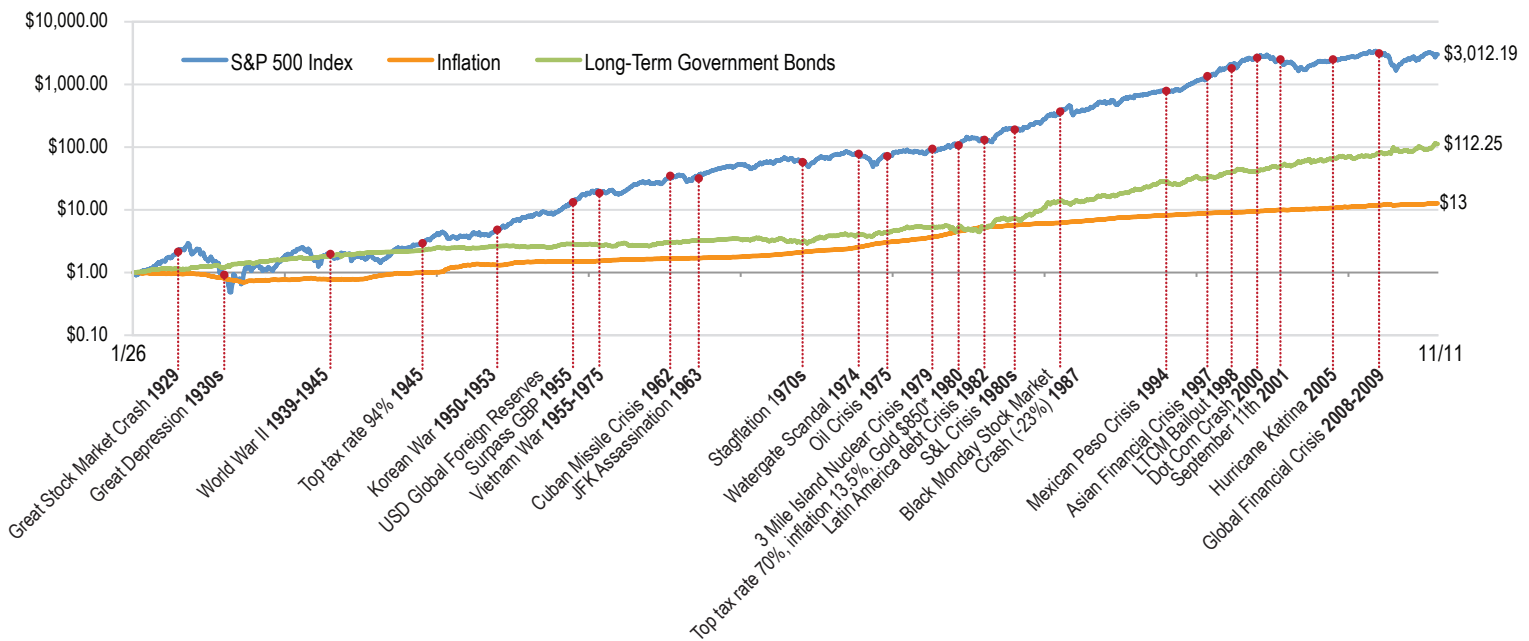
That fear can often cause us to sell at the exact wrong time. As Warren Buffet once noted, we should be fearful when others are greedy and

greedy when others are fearful. It is precisely because of risk and uncertainty that we expect to receive a return on our capital. We wouldn't lend a dollar to a stranger if we didn't think we would get more than a dollar back in return.

Over the long term, we can see that investors have, historically, been significantly rewarded for staying invested in stocks. As you can see from the chart below \$1 invested in the S&P 500 in 1926 would have turned into \$3,012 by November of 2011, an annualized return of 9.77% – and this despite the number of serious national and global challenges. Stocks are the most volatile asset class shown, but they also have returns significantly higher than that found in Long-Term Government Bonds or Inflation which would have grown a dollar to only \$112 or \$13 respectively.

Fears of U.S. and European debt will likely dominate the headlines for some time to come. Politicians, credit rating agencies and foreign wars can create negative headlines at any moment. We will have quarters like Q3 of 2011 where large losses occur. 2012 will bring unpredicted new challenges. But if we've learned one thing over the last 85 years it's that capital markets do work, and investors with long time horizons have historically been well rewarded for placing their capital at risk. 🌐

### Growth of a Dollar January 1926 - November 2011



\*\$2,395 in 2010 USD inflation adjusted.

Risks associated with investing in stocks potentially include increased volatility (up and down movement in the value of your assets) and loss of principal. Indexes are unmanaged baskets of securities that investors cannot directly invest in. Past performance is no guarantee of future results. Hypothetical value of \$1 invested at the beginning of 1927 and kept invested through December 31, 2010. Assumes reinvestment of income and no transaction costs or taxes. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Total returns in U.S. dollars. Long Term Government Bonds, and US Consumer Price Index (inflation), source: Morningstar's 2011 Stocks, Bonds, Bills, And Inflation Yearbook (2010); The Standard & Poor's 500 Index is an unmanaged market value-weighted index of 500 stocks that are traded on the NYSE, AMEX and NASDAQ. The weightings make each company's influence on the index performance directly proportional to that company's market value.

# When There's a Will, There's Not Necessarily a Way

## The Importance of Updating Beneficiary Designations

By Eric Golberg, CFP®, Director, Wealth Management, Loring Ward

**Question:** *What does \$14 trillion represent?*

**Answer:** *The amount of money held in tax-deferred retirement accounts (i.e. IRAs, 401(k)s, etc.).\**

For many Americans, the bulk of their net worth is held in these retirement accounts. But many don't understand the importance of one little form that governs the ultimate disposition of these assets — the beneficiary designation form.

There is a widespread misperception about how assets pass at death. Some assets are passed via will and are considered probate assets; but some assets are governed not by what the will dictates, but by the beneficiary designation. Some of these assets include retirement accounts and life insurance policies. Making sure beneficiary designations are complete and up to date is just as important as ensuring that you have other estate planning documents in place, such as a will, health care proxies and powers of attorney.

Here are some of the common mistakes that occur with beneficiary designation forms:

1. **No beneficiary named** — Believe it or not, this is generally the most common mistake. In the case of an IRA, not naming a beneficiary can mean that the ultimate recipient will have a shorter

period of time to withdraw the funds than if a beneficiary had been named.

2. **Naming the estate as beneficiary** — If a beneficiary is not named or the beneficiary predeceases the IRA holder, the estate usually becomes the beneficiary. If the estate is beneficiary, the IRA becomes a probate asset and has to go through the probate process, which costs money and time. Additionally, the IRA would generally need to be paid out over a shorter period of time than if a beneficiary had been named.
3. **Lack of a contingent beneficiary** — If the primary beneficiary dies before the IRA holder and no contingent beneficiary is named, the IRA will be deemed to have no beneficiary.
4. **Not naming all children as beneficiaries** — There have been cases where individuals have not named all their children as beneficiaries because there was not enough room on the form and because they thought that since all of the children were named in the will, it didn't matter. Also, if you intend to leave your IRA to multiple children, make sure you define that you want it left in "equal shares." There was a case where a mother with six children

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### What a Long, Strange Trip It's Been.... *continued from Page 1*

should abandon your international stocks. From 1972 to 2010 a portfolio of 50% U.S. stocks (as represented by the S&P 500 index) and 50% International stocks (as represented by the MSCI EAFE index) had 4.1% less volatility on an annual basis than a portfolio that was 100% U.S. stocks.\*

#### Focus on the Long Term

If you invested \$1 in the Dow at the beginning of 2011 you saw that dollar grow to as much as \$1.11 and sink to as little as \$0.94. However, if you remained invested the entire year your initial investment would be worth \$1.07 at the end of November. Remember, since October of 1987 the Dow has been positive 181 months and negative 109 months. Don't focus too much on the short-term movements of the stock market because they are not representative of the long-term average. If you have an investment plan in place, stick with it until something changes in your life that necessitates a change in your plan.

#### Market Returns are Unpredictable

Going back to our previous example, if you invested \$1 in the Dow in January, that \$1 would be worth only \$0.96 at the end of September — and you would not be feeling good when you opened

your quarterly statement and realized that you were down roughly 4% year to date. In fact, many investors would be discouraged at this point and pull out of the market. However, patient investors realize that things can change quickly. By the end of November your \$0.96 is worth \$1.07, growing approximately 11% in two months. Moving out of stocks when the market is down is a sure way to lock in losses.

#### Don't Forget Dividends

Even though stock prices fluctuate, many companies still pay dividends when their stock price is down. If we look at the return of the Dow — without including dividends — from the beginning of the year through November, the index was up only 4%. But if we include the roughly 3% that was received in dividends, the index was up almost 7% through November. Even though the price of your portfolio may be down, if you sell you may forego dividend income.

We can learn a lot from our strange trip during 2011. Most importantly we learn that it takes time to build wealth in the stock market, and as we increase the amount of time that we are invested, our probability of a negative return declines. We invest with a goal in mind and keep focused on that goal until we reach it. As the Grateful Dead sang it, "Takes time, you pick a place to go, and just keep truckin' on." 🎵

\*Morningstar Direct 12/12/2011

## Investments in Culture Wars

By Meir Statman, *Glenn Klimek Professor of Finance, Santa Clara University*

We live in unsettled times, with high unemployment, a volatile stock market and a failed Super-Committee. Europeans face even greater uncertainty, with government collapse in Greece and Italy and a possible unraveling of the euro and the European Union. Culture wars will also continue to unsettle our portfolios and financial plans. But we should not let culture wars distract us on our way to our financial goals.

### Cultures of Hard Work or Luck and Connections

What do you think brings greater prosperity – hard work or luck and connections? World Value Survey posed this question to people in the United States and Europe, and the responses say a lot about the cultures of these countries.

Alberto Alesina of Harvard and George-Marios Angeletos of MIT found substantial differences between the answers of Americans and Europeans.\* Americans generally believe that riches come from hard work, whereas Europeans are more likely to believe that riches come from good luck or connections. The World Value Survey reveals that only 16% of Americans believe that riches are due mostly to luck compared to 25% of Europeans; and 71% of Americans think that the poor could become rich if they just worked hard enough, whereas only 40% of Europeans think so.

Income inequality is greater in the United States than in Europe, yet Americans are less inclined than Europeans to favor high taxes that distribute income from rich to poor. The differences in perceptions also affect the willingness of Americans to work harder than Europeans.

The war between those who believe that riches come from hard work and those who believe that riches come from luck or connections is mostly a war of words when money is flowing, whether from economic booms or from borrowing. But the war takes to the streets when the flow of the money stops. This is what is happening in Greece, which borrowed more than it could pay and provided safety nets it could not afford. The culture of Greece is a culture of connections, where the government grants unnecessary jobs to those who gather votes for it and where hairdressers are entitled to retire at 50 with generous pensions. The situation in Italy is hardly better.

### Investments in Culture Wars

These culture wars will continue to make financial markets volatile, increasing the value of our portfolios one day, only to kick them in the following day. Stock prices will go up or down as investors believe that the culture wars will come to good or bad ends, much before good or bad ends come. Witness the 490 point jump in the Dow Jones Industrials Index on November 30 — its seventh-best daily gain in its history — on news that central banks around the world slashed borrowing costs for banks in order to shore up the European financial system and prevent the region's debt crisis from getting worse.

The same is true for the link between the fate of the economy and the fates of our own portfolios. Witness, for example, the relation between stock prices, reflected in the S&P 500 Index, and the state of the

economy, reflected in the unemployment rate. Our unemployment numbers are not much better today than they were in February 2009, yet the S&P 500 Index increased by 23.77% between the end of February 2009 and the end of November 2011.

Whether we believe riches come from hard work or luck does not matter. What does matter is whether we can control our investing “emotions” even in times of turmoil. Don't let volatility — or concerns about cultural conflicts — lead you to make investment decisions you'll regret later. ☺

Professor Statman is a member of Loring Ward's Investment Committee.

*\*Alberto Alesina and George-Marios Angeletos “Fairness and Redistribution: US vs. Europe,” American Economic Review, September 2005, 95: 913-35*

### When There's a Will.... continued from Page 3

left out the words “equal shares” and as a result, the IRA custodian interpreted her intent was to leave the IRA to her first child with the other five as contingent beneficiaries.

5. **Naming a minor child as a beneficiary** — Since a minor lacks legal capacity, naming a minor child as beneficiary creates a set of problems. One alternative is to create a trust for the benefit of the child as beneficiary. Assuming the trust meets certain requirements, payments from the IRA could be “stretched” over the child's lifetime. Another alternative would be to name a custodian under the Uniform Gift to Minors Act (UGMA) for the benefit of the child. This is a less expensive option than creating a trust, but the downside is that the child will inherit the IRA outright when he/she turns 21.
6. **Naming an ex-spouse** — This is where things can get ugly. Even if the divorce agreement and property settlement stipulate that one spouse (the wife, let's say) has no claim on her ex-husband's IRA, if the beneficiary designation form isn't updated, the ex-wife would be entitled to the IRA. There have been numerous instances where these disputes have ended up in court, and the court has unanimously upheld the validity of the beneficiary designation, regardless of what a will or divorce agreement says.

As you can see from the above scenarios, it is important to understand the implications and importance of completing the beneficiary designation form correctly. These forms should be coordinated and consistent with your overall estate plan, and should be discussed with your advisors as well as an estate planning attorney. In addition, it is a worthwhile exercise to review these forms on an annual basis, or upon a change in life situation. ☺

\* www.EBRL.org, “Fast Facts”, #203, 6/30/11

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