

# Current Observations

FINANCIAL & INVESTMENT MANAGEMENT GROUP, LTD. • FEE-ONLY WEALTH MANAGEMENT

## Money Doesn't Manage Itself



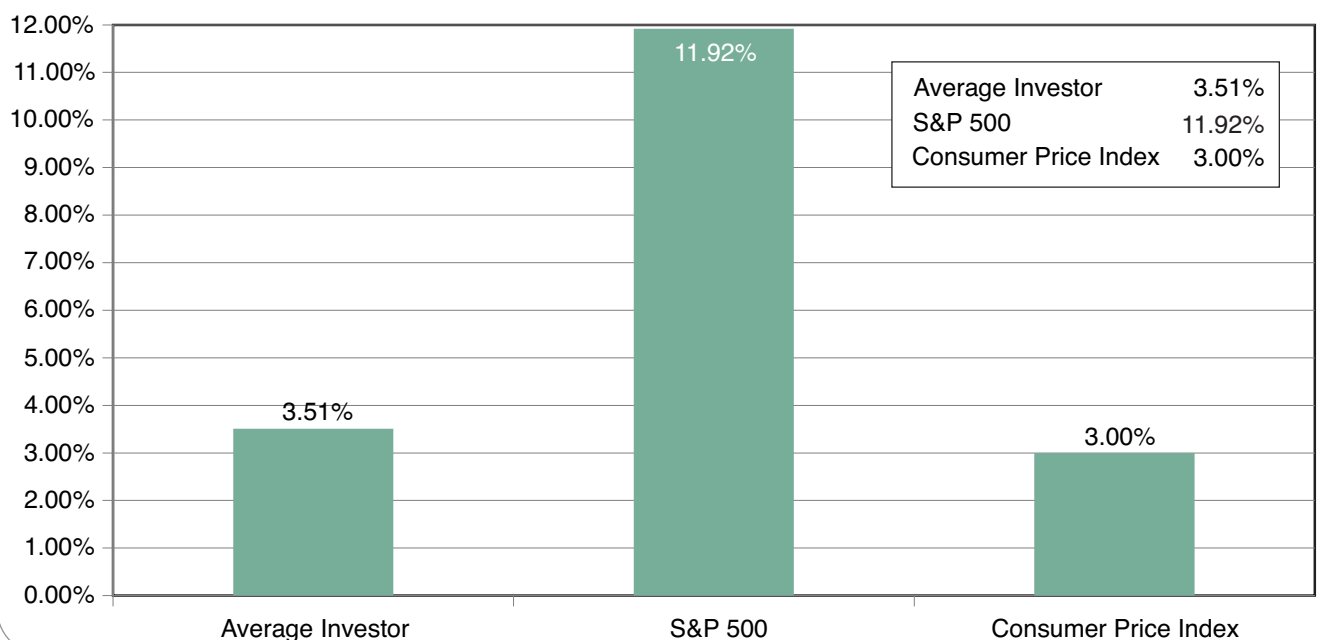
by Paul Sutherland

His insight tells us we should have been 100% in cash all this year and now investing in long-term investments. Today we can lock in great yields on U.S.-backed TIPS (Treasury Inflation-Protected Securities), common stocks and bonds that, in some cases, pay more than twice what we could have gotten even a few months ago.

What is amazing is that many of today's long-term investors are selling off their investments and going to cash. Money market funds have never had a greater percentage of an investor's nest egg than today.

DALBAR, Inc., a client service rating organization, examined the flows in and out of common stock investment funds over a 20-year period. Their findings (below) were quite remarkable, and until this year, I doubted their results. But after the year we've had, I am a believer. I do, however, think the study overstates the fickleness of the average investor, who jumps from cash to stocks and back again based on emotion, fear and greed. But their findings illustrate a cognitive bias known as the *recency effect*, in which people tend to be more influenced by the most recent events or experiences rather than considering their overall "history" in the decision-making process.

### Annualized Returns from 1985-2004



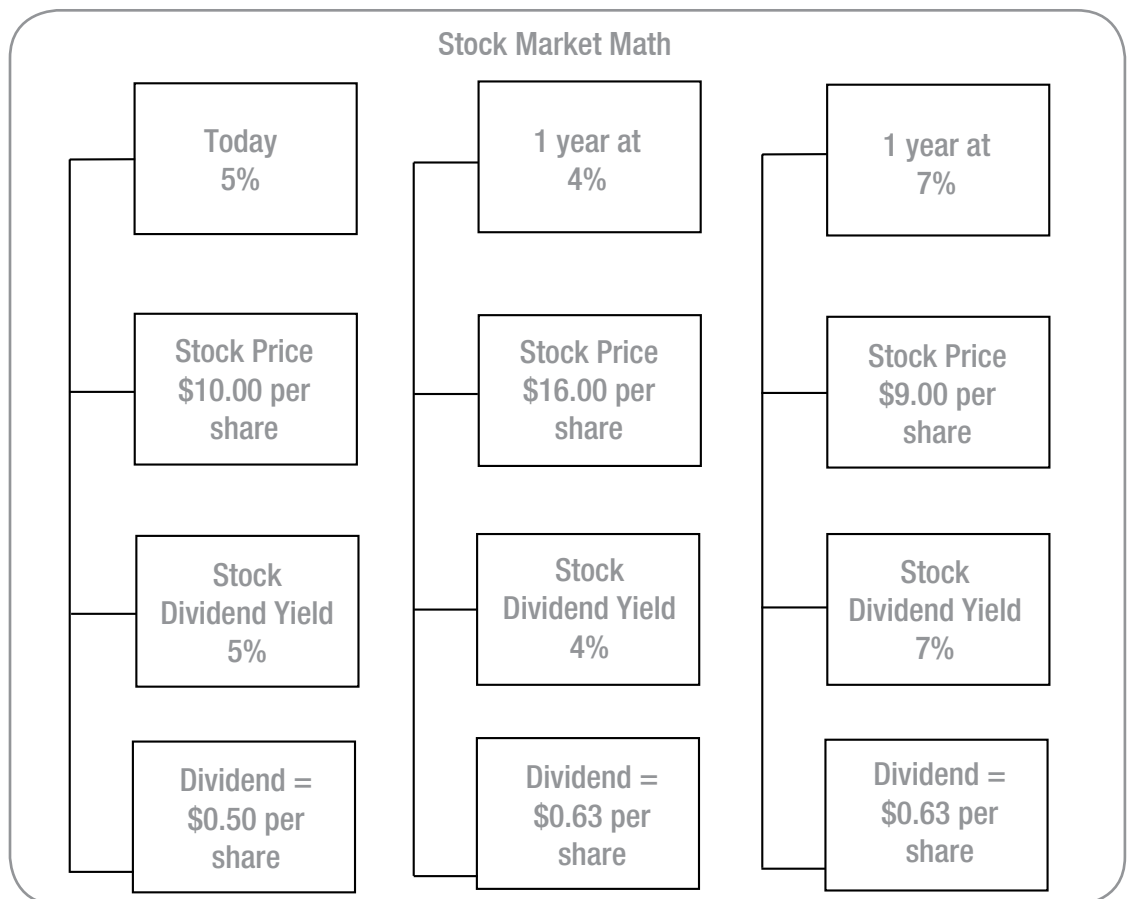
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In other words, as Daisy Maxey pointed out in her article, "Protecting the Investments of Bad Investors," "[Investors] pour in cash as markets rise and start a selling frenzy after a decline" (The Wall Street Journal, online edition, July 19, 2007). Conclusion: Investors make these mistakes because they are "driven by fear that the markets will not recover." Conclusion! Investors left to their own devices tend to sell low and buy high, chase yesterday's instead of tomorrow's results, and let emotions drive their investing.

Even with today's market, every investor who has read The Intelligent Investor, by Benjamin Graham and David Dodd, should be completely optimistic that going forward investment returns will trounce cash, CDs, government bonds and fixed annuities. Today, *cash is trash* for long-term investors. Naturally, short-term investments are good for those who need cash during the next six to 12 months, but why

would investors feel good about getting a few percent on cash when they can get more than 5% or 6% in cash dividends on many great well-managed companies, in good solid industries, with quality finances that pay dividend yields rarely seen and have the potential for growth in both price and dividends. Of course the securities could go down more – and some companies will fail – that is why you analyze and diversify.

Let's also assume that we have a long, drawn-out recession, investors get tired of the low return rates on their "safe" money market investments, and they decide to venture back into stocks that offer at least 4% cash dividend yield. Today investors are demanding higher (potential) future returns. As illustrated in the Stock Market Math in Action chart below investors can drive a \$10 stock to \$16 or decrease the price per share to earn a higher dividend yield.



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### Markets Are Like the Weather

Like the weather, we have no control over the markets. Stocks, bonds, real estate, CDs and all financial markets are influenced by earnings, growth, dividends, management, interest rates, liquidity, investors' expectations, government policies, inflation expectations and thousands of other trends and counter-trends.

We can, however, control our actions in response to the markets. There's no excuse to go into a personal financial fetal position, call on our government to compromise capitalism or overreact on the regulation or deregulation front. Historically, governments have always been both part of the problem and part of the solution. Investors, likewise, have been ... well ... as fickle as the weather. They say with patriotism and pride that they believe in the free market system, then as soon as their portfolios drop, fear consumes them and they set aside their beliefs.

"Financial" markets have existed since the 11th century and some form of cooperative capitalism has always been the model. Today's markets are much more complicated and sophisticated, but they exist simply because people exist. All countries, business, non-profits, people and governments cooperate, negotiate, seek and compete for resources. As long as this economic activity continues, financial markets will continue. Economic activity will exist as long as people wish, work and seek happiness.

### Success

If you look at successful institutional investors, you will find that they have both a strategy and a plan. I have not heard of one endowment, large pension plan, insurance company, foundation or long-term, professionally managed investment pool going to "cash" or even raising "cash" in an unstable economy. They use history

as their guide, not fear, because they realize that successful long-term performance will be subjected to some volatility. Most have a disciplined range of parameters that dictate how much is allocated to stocks, real estate, bonds, metals, international investments, special situations/opportunities and cash. And as we do internally at FIM Group, many plans have allocation parameters that might look like, for example, 25% to 50% in stocks for a conservative account – more when stock expected future yields are high (like today) and less when not.

Effective institutional investors are not reactive and emotional in their response to the current financial malaise (although I'll bet they have some long trustee meetings). Rather, they focus on the things they can control. And, of course, successful institutions and people do accept responsibility for things within their control. They recheck their policies, learn from them and rationally make necessary incremental changes.

Lastly, successful organizations (and people, of course) need to function with sincerity, objectivity and humility and say to themselves, "What could we have done differently? How can we learn from this? Are we asking the right questions? Are our assumptions good and solid?" So naturally we say we should have gone 100% to cash in January and reinvested it today – because, thankfully, we have 20/20 hindsight.

### Scenario Planning

Retirees need to stay retired with good income security. People wishing to retire or build wealth for a future event need to grow their capital. In scenario planning, any way you construct it, a strategy of strictly money markets and CDs today would be a way to guarantee failure. Most every scenario, except a short-term one, indicates that now is the time to add stocks, income, real estate, corporate bonds and other

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long-term assets to a portfolio, not cut back on them. When you have TIPS with principal and income returns guaranteed by the U.S. government, you can lock in returns of over 3% more than inflation, you know that opportunities have been created by the fear and reactive investors running for cover and selling without forethought or any scenario analysis.

**Opportunities, Taxes and December 31**

Dynamic management is the key to our year-end strategy: When markets recover, there will be winners and losers. And though we will use indexes to tell us the “investment weather,” so to speak, they will obscure what is really happening. Studies show that coming out of bear markets, stocks with great dividend yields do better in price appreciation and total return. So even for our growth accounts we will continue to purchase dividend-paying securities, which means selling other investments to buy the investments that we feel will do well in the market recovery.

We are also making several assumptions that will influence our investment strategy:

- 1) Markets will recover
- 2) Investors will be attracted once again to well-known investments – so-called blue-chip investments
- 3) The real action from a performance point of view will be in emerging economies. This means that we will either invest directly in overseas companies or in domestic companies with significant overseas operations
- 4) The economy in the U.S. and most of the world will be slow with little, none or negative growth. We feel the price of many securities are already reflecting a contained depression, so if economic life goes on even slightly better than comatose, many investments should do well
- 5) There will be winners and losers. Many banks and financial institutions made bad loans, threw out the risk management rule book, and will have continued trouble earning money.

Many retailers are just plain “faddish” and will have trouble competing with the Wal-Marts, Carrefours, Costcos and other discounters. We also think that poorly managed companies and companies with poor-quality balance sheets will have trouble attracting capital, and thus our objective is to avoid those types of companies. We strongly believe that we are in a global energy mega trend that will benefit forward-thinking, “greener” companies that promote renewable energy, gas conservation, fuel efficiency, batteries, electricity, wind power and solar power. We also see huge opportunities in emerging economies with billions of people who not only desire, but will work for a better life. Also as the population ages in the developing world they should benefit from advances in health care, travel, healthy lifestyle products, telecommunications, etc.

- 6) Governments will become more involved in the economy and businesses with new regulations and ultimately contribute to the “winners and losers”.
- 7) Investors will continue to be manic and cause volatility, which creates opportunities for profit
- 8) All this money being pumped into the economy should (in the long-term) lead to inflation and U.S. dollar weakness – for now we have deflation
- 9) Wealth will be transferred from short-sighted short-term investors to long-term investors with foresight to buy securities and investments at bargain prices. We will see an increase in strong companies buying or merging with weak ones
- 10) We will see weakness in the stock and bond markets through December 2008, for three main reasons: a) Taxes – investors selling to lock in tax losses on investments that have gone down. Therefore selling pressure will be around for a few more weeks; b) Hedge funds unwinding; and c) People will just sit on the sidelines until 2009.

All this plays well into a strategy of being thoughtfully invested going into 2009 and at FIM Group, we are making sure our allocations to stocks in our portfolios have significant

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cash dividends, complete, solid balance sheets and good future prospects. We are continually researching industries such as health care, pharmaceuticals, telecommunications and energy, in which companies serve emerging economies and benefit from our aging society. **F**

Happy Holidays! *Paul*

## Last-Minute Shopping



by Zach Liggett

**B**y the time this newsletter hits your mailbox, you will probably have less than 10 days to get your act together and finish your holiday shopping. In other words, the time for lollygagging is over. To help your cause, I've put together a few last-minute holiday gift ideas that all relate

to holdings in FIM Group-managed portfolios, providing a double opportunity to finish your shopping and throw top-line support to some of the companies you own.

So let's get started with a great multi-purpose stocking stuffer. Tiger Balm is an herbal ointment that originated in the old imperial courts of China to relieve and soothe body aches and pains. It is versatile enough to help with arthritis relief, muscle sprains and even bug bites. Haw Par Corporation ([www.hawpar.com](http://www.hawpar.com)), a Singapore-listed health care, leisure and property conglomerate, has grown the Tiger Balm brand over the past century into a global franchise that has become the core of its health care business. Haw Par is debt-free and trades at only 40% of book value, a level last seen during the late '90s Asian financial crisis. The company should pay a 5% dividend yield in 2009.

For the youngsters on your list, how about an educational toy from Action Products International ([www.apii.com](http://www.apii.com))? Action Products is

focused on managing a portfolio of non-violent and educational toy brands, including Space Voyagers, Curiosity Kits, I Dig and Kidz Workshop. Our portfolio team has met with their new management, and we feel good about their plans to bring much-needed restructuring to the company. We expect a recovery in profitability, even in a weak economic environment, as this restructuring bears fruit in 2009.

Speaking of fruit, a gift basket of pineapples, bananas and melons might be a hit with the fresh fruit junkie on your list. Fyffes ([www.fyffes.com](http://www.fyffes.com)) is an Ireland-listed global distributor of tropical fruit. Management has ambitious plans to significantly grow its business over the next five years both organically and via acquisitions of smaller distributors. Fyffes trades at only 8x next year's expected earnings and should offer a 5% dividend yield in 2009.

If shopping for pineapples causes you to start dreaming about warmer, tropical locales, perhaps a radiant underfloor heating system from Uponor ([www.uponor.com](http://www.uponor.com)) would be a nice gift for the family. Uponor's heating systems are increasingly being installed for their comfort, energy efficiency and air quality enhancement (no dust spewed into the air). For our fortunate Hawaii clients who aren't quite as concerned about staying warm, Uponor also offers radiant cooling systems. Although the headwinds of slowing global economic growth will impact Uponor in the near-term, the company's unique, environmentally sound heating/cooling and plumbing products should benefit as living "green" continues to gain mainstream acceptance. Uponor trades at around 10x expected '09 earnings and should pay at least a 10% dividend next year.

For those with a bit more room in their budgets (and still daydreaming about tropical weather), how about a brand-new, high-end luxury condo in Hong Kong? Cheung Kong Holdings ([www.ckh.com.hk](http://www.ckh.com.hk)) is a Hong Kong-

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LAST-MINUTE ... continued from page 5

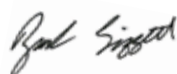
listed multi-national conglomerate with core activities in property development, telecommunications, ports and energy. Luxury residential developments account for roughly 8% of Cheung Kong's net asset value (NAV), and Cheung Kong has a good track record of selling out its developments even when the economy softens. We have been buying the stock for some of our strategies at nearly a 40% discount to NAV and expect to benefit longer term as the NAV grows and the discount to NAV narrows.

Hopefully, these ideas help your dash to the shopping finish line and remind you of some of the promising companies we own in FIM Group-managed portfolios.

If you don't already have wrapping paper, I might suggest an alternative route this year that a few years ago would have branded you a cheapskate, but now deems you hip and green. Recycle a few sections of *The New York Times* ([www.nytimes.com](http://www.nytimes.com)), *The Washington Post* ([www.washingtonpost.com](http://www.washingtonpost.com)) or *The Wall Street Journal* ([www.wsj.com](http://www.wsj.com)), and use them to wrap your goodies. When all the wrapping is done, sit back with a cup of organically decaffeinated coffee ([www.swisswater.com](http://www.swisswater.com)), survey your work, and maybe slap on a little Tiger Balm to keep those joints loose for all the unwrapping ahead.

Oh yeah, one last thing. Make sure you call those loved ones who won't be able to spend the holidays with you. A simple call will probably mean more to them than any gift, and depending on where they reside, the call will probably travel via portfolio holdings ATT ([www.att.com](http://www.att.com)), Deutsche Telekom ([www.telekom3.de](http://www.telekom3.de)) or Shin Corp (Thailand, [www.shincorp.com](http://www.shincorp.com)).

Happy holidays everyone, and best wishes for the New Year!



## Beneficiaries



by Alice McDermott

“Whom should I name as beneficiary on my retirement accounts?”

This question is often asked by clients and is worth addressing. The primary advantages to naming beneficiaries are: 1) You have control regarding who receives the assets upon your death; and 2) You avoid probate and its associated costs.

Similar to life insurance policies, retirement account holders designate exactly who shall receive the funds. Failing to do so, or naming only one primary beneficiary without naming a contingent (back-up) beneficiary, can result in either the state of domicile or the terms of the retirement account determining who receives the money. In most cases, the assets will automatically transfer to your estate and will be subject to probate, which can lead to an undesirable outcome. Thus, consideration needs to be given in naming your beneficiaries to ensure it meets your goals and are in line with current estate tax law.

There are three key issues that we recommend clients give careful thought too in naming beneficiaries. First, we recommend that you name both a primary and contingent beneficiary. This will help preserve your ability to participate in advanced estate planning around your retirement assets and help avoid the probate process if your primary beneficiary fails.

Second, we recommend that you name individuals specifically, versus groups such as “all children equally”. This will aid in the efficient administration of your estate upon your death.

If your goal is to preserve a beneficiary's share of your IRA, such as your child, for their

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children, upon the event of a child predeceasing you, you should review with your attorney the appropriateness of adding language such as “per stirpes” or “to their issue by right of representation” to their names. Without this language you could unintentionally disinherit a grandchild under this scenario. This is a very complex estate planning area, which varies by individual state distribution rules. Therefore, we recommend that you consult with your attorney regarding the appropriateness of your beneficiary language and review these periodically to make sure they are consistent with your future planning objectives.

As a general rule, beneficiaries can legally take control of the funds after presenting a death certificate to the custodian of the account. This is beneficial should they decide to roll the funds into their own IRA. If, however, they choose to take an outright distribution, it is considered taxable income and may also incur a penalty. With retirement accounts, in most cases, it is more beneficial to name your spouse as the primary beneficiary and your adult children, equally, as contingents. If you have no spouse and/or children, an alternative could be other adult family members. The point is that you control asset distribution, not the state or account custodian.

Some clients believe that if you create a Revocable Living Trust, you should automatically name the trust itself as the primary beneficiary, overriding all other considerations like your spouse. This can create problems and reduce flexibility, thus causing an undesirable outcome. Having said that, naming your trust as the contingent beneficiary may be more advantageous, especially if your children are minors. Regardless, the trust needs to meet the requirements to be a qualified beneficiary, otherwise, the assets may need to be withdrawn within five years of the date of death of the account holder. We recommend that clients who are interested in naming their trusts as primary or contingent ben-

eficiaries consult with their attorney to ensure that it coordinates with their estate plan and any specific language for naming their trusts.

As you can see, the rules for distribution are very complex. To avoid the pitfalls, it's best to discuss your wishes with a certified financial planner or an estate planning attorney. Because everybody's different, there is no one-size-fits-all approach when it comes to naming beneficiaries. As always, if you have any questions or concerns or would like to us to review your current beneficiaries, please give us a call. **F**

## FIM Group News

Please visit [www.fimg.net](http://www.fimg.net) to view our most recent webcast “*Looking Forward into 2009*” with Paul Sutherland. If you are unable to view over an internet connection, please call us at 231.929.4500 to request a DVD.

### The Quiz

In 1602 what company issued the first public shares for purchase on the Amsterdam Stock Exchange?

- A. City of London Corporation
- B. Hudson Bay Company
- C. Dutch East India Company

*Answer online at [fimgquiz.com](http://fimgquiz.com) to be eligible for a monthly prize.*

### Quote

“I've found that when the market's going down and you buy funds wisely, at some point in the future you will be happy. You won't get there by reading *Now Is The Time To Buy.*”

– Peter Lynch

### Disclosure

Performance data quoted represents past performance. Past performance does not guarantee future results. All performance assumes reinvestment of dividends and capital gains. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Performance data current to the most recent month-end may be obtained by calling 231.929.4500.

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