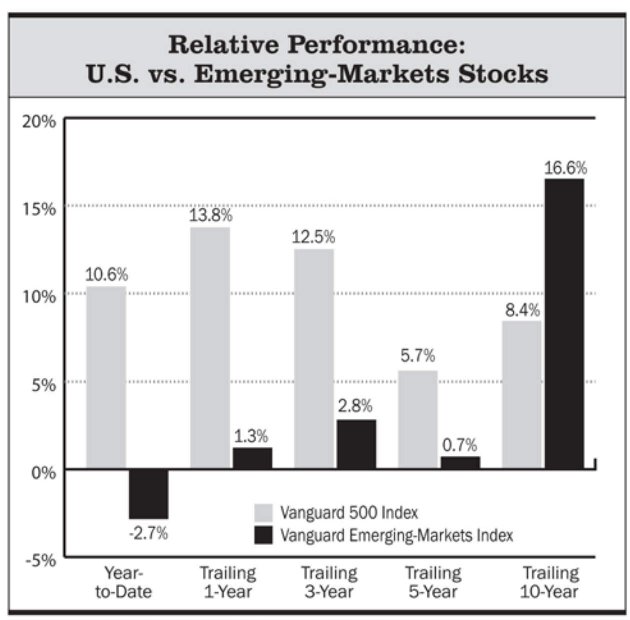
April 8th, 2013

Here is our newsletter for the 2nd quarter of 2013.

The Markets
U.S. stocks moved sharply higher in the first quarter, with the S&P 500 hitting new all-time highs with a gain of 11%. Despite worrisome developments in the eurozone, developed international stocks gained roughly 4%. Not all risky assets performed equally well, however. Emerging-markets stocks were down 4%. So the U.S. stock market was a huge outperformer.

Treasury bonds and the Aggregate Bond Index (our proxy of traditional bonds) ended flat for the quarter. The yield on the Aggregate Bond Index was 1.8% at the end of the quarter compared to just below 1.6% at year end. In terms of total return, municipal bond returns were also flat for the quarter. Developed foreign bonds were down 3%, due in part to currency weakness against the U.S. dollar. Emerging-markets currencies also declined in aggregate, eating into the higher yields generated from local sovereign bonds, which ended flat for the quarter.

Our Portfolios
Late in the quarter we added to our emerging market stock holdings. These markets have trailed the U.S. markets over the last 5 years and now offer significantly better valuations than the U.S. stock markets. This plus changes made late last year have increased the share of foreign stocks in our portfolios to about 60/40 U.S./foreign. Note our total stock allocations are still around ½ our neutral allocations.

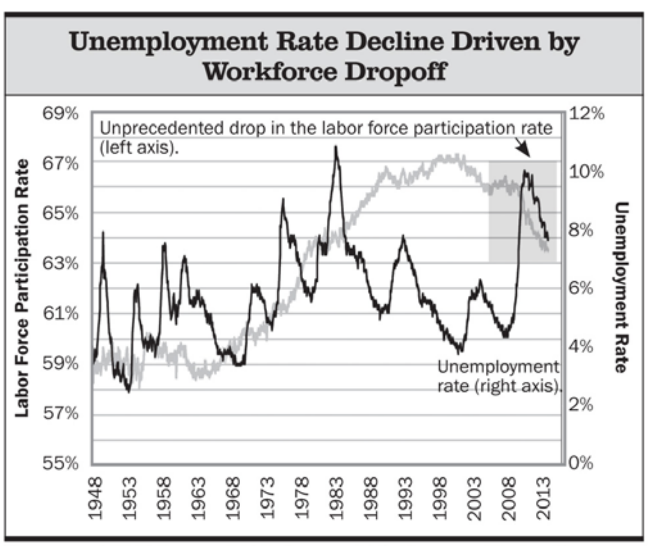


Data as of 31 March 2013. Source: Morningstar.

Our fixed-income positioning continues to heavily underweight traditional investment-grade bonds in favor of alternative asset funds. With the current Aggregate Bond Index yield so low and stock valuations similarly overpriced, we view the risk of damage from rising rates as significant and choose to use alternatives to reduce the damage if rates rise and improve the diversification in our portfolios.

The Economy and Corporate Profits
The U.S. economic fundamentals have continued to slowly improve. At the beginning of every year since the Great Recession most expect this year to be the year when the economy picks up steam. As you can see from the chart below the unemployment rate has been falling slowly over the last 4 years. However, most of the increase in the unemployment rate has been driven by a sharp drop in the labor force participation rate, meaning there are fewer people working or seeking work, which is not a good thing. Around 1/3 of this participation rate drop can be attributed to the baby boomers retiring. Most of it is due to younger kids getting out of school and not entering the work force and also simply due to discouraged workers dropping out.

The strongest part of the recovery has been in corporate profits of the large U.S. companies and the subsequent rebound in their stock prices. The chart below shows the profits as a percent of GDP hitting record highs (profit margins are also at records). In our January 2008 newsletter we warned of at least a profit recession coming when we said "earnings have risen well above the long-term trend the last couple of years. The simple fact that earnings always eventually revert back to the mean tells us we could have a 15% drop in earnings before we even get back to the mean trend." Actually the S&P 500 earnings growth in 2012 was actually slightly negative for the year so profits are already coming down. This reversion to the mean won't be good for the economy, for corporate profits or for stocks.



Data as of 28 February 2013. Source: U.S. Bureau of Labor Statistics.

Data as of 28 February 2013. Source: U.S. Bureau of Economic Analysis.

Maximize Your Social Security Benefits
In our newsletter of July 2012 we talked about how you can maximize your Social Security benefits. Since then we have helped three married couples maximize their benefits using our

analysis. We use a separate program to compare benefits for the client's current plans to alternative strategies few even know about. We assume both live to age 90 (there is an almost 50% chance for one of them to do so). We then calculate the value of all benefits for their selected strategy and then find the strategy that gives them the maximum value. The values are expressed in today's dollars (present value). Here is a summary of the results.

	Couple #1	**Couple #2**	**Couple #3**
Current age; him/her	61/57	64/70	65/66
Current Plan	He is retiring in a few months. They both plan on taking their retirement benefit at their normal retirement age of 66.	She is already taking her retirement benefit. He plans on taking his retirement benefit at 65.	She took retirement @ 62. He plans on taking retirement benefit right away.
Recommended Maximized Plan	He files+suspends @ 66 then takes retirement @ 70. She takes spousal benefit @ 66 then retirement @ 70.	He should take spousal benefit @ 66 then switch to retirement @ 70. She should switch to a larger spousal @ 76	She should suspend her benefit then restart in 4 years. He should take spousal @ 66 then retirement @ 70.
Present Value-Current/Maximized	$787k/$875k	$826k/$888k	$858/$952
Benefit-Present Value	$88,000	$62,000	$94,000

The average increase in income for choosing the maximized strategy is $81,000 in today's dollars. Note we also ran scenarios at shorter life spans. The benefits are lower but still substantial. The benefit of delaying your retirement benefit is an increase of you benefit when you do take it by 8% per year plus the cost of living increase (which has averaged around 3.5% over the long term). Filing and suspending enables your spouse to take a spousal benefit on your record while enabling both retirement benefits to continue to increase. Only one can take a spousal benefit at the same time but you can start one type of benefit and switch to another later. Also note increasing your retirement benefit increases the benefit your spouse can get as a survivor (yes Social Security is also is a form of life insurance with survivor benefits).

The benefits for those who live longer are greater. The next step is to take these figures on Social Security income and plug then into your retirement plan. We explore what other sources of income you have in the early years before your full benefits kick in. We also incorporate the tax ramifications (Social Security benefits are taxed differently but no more than 85% are taxable under current law). What we're dealing with is the risk of outliving your nest egg. The longer you live the higher your lifetime expenses will be and the more income you will need. Increasing your Social Security benefit over the long haul will help secure your retirement.

Fidelity Income Planner-You Get What You Pay For
Earlier this year a couple in their 50s asked me to help them plan for their retirement among other things. They have all their investment accounts at Fidelity and have been using their Fidelity Income Planner to estimate when they could retire. They have been hoping to retire and/or downsize from his high paying yet demanding career in the next few years, but no longer than 7 years from now. They both will qualify for Social Security and also have two pensions which, along with their Social Security should fund over ½ of their retirement expenses. They have a current retirement nest egg of about $750,000 and are contributing the maximum to their retirement plans and are paying an extra $100,000 per year on their mortgage to pay off their home loan in less than 2 years.

The client described the results from the Fidelity plan as discouraging, indicating they would have to work at least another 7 years full time, perhaps longer. I put together a comprehensive financial plan for them and got vastly different results. Based on the same information they had given Fidelity, my projection showed they could retire in no more than 7 years, maybe only in 4.

How did Fidelity and I come up with such different results? After presenting my results I reviewed the Fidelity plan. We both looked at the variability of investment returns and their effect on the outcome. The big difference turns out to be the projection of their nest egg in 7 years. Theirs showed their nest egg growing from $750,000 to $1,092,000 over 7 years whereas my projections showed their nest egg growing to about $2,400,000. The difference was not in investment returns but simply the fact that Fidelity ignored the over $100,000 in annual surplus cash flow before retirement that could be used to eliminate their debt and add to their nest egg. Adding to their nest egg increased the value of it many times more than the value of any investment returns.

I asked the client how much they had paid for the Fidelity plan and the answer was nothing (well actually they were paying for Fidelity's investment advice which consisted of advising them to buy Fidelity mutual funds). I asked him if he thought he got his money's worth. They could laugh about it now because they had developed a much clearer understanding of their whole financial picture and that picture showed their retirement may not be that far off after all.

Thank you for reading and let me know if I can help you or anyone you know.

Sincerely,

Stan Johnson, CFP(R)
Comprehensive Financial, Inc.
Registered Investment Advisor