

SELECTING THE COURSE – *and Staying the Course*

March will mark the first anniversary of the worst 12-month decline in investment markets in modern history. This momentous decline was followed by an equally rapid, sustained, and correlated rise in investment prices. With a year's perspective, now is an excellent time to re-examine long standing principles of professional investment to see how well they served investors during this period of unprecedented stress. From this analysis, we can explore what adjustments will provide better protection in severe downturns, while still achieving positive inflation-adjusted, after-tax returns.

To this end, we reviewed the performance of many client portfolios over the past several years. We also studied numerous industry reports analyzing the performance of a variety of investment strategies. Our conclusions fall into two categories: (1) selecting the course and (2) staying the course.

Selecting the Course

We found that strategic asset allocation and diversification continued to be the primary determinants of portfolio performance. Diversification among asset classes did not

provide as much protection as most had expected because many asset classes became more correlated than in the past; on the other hand, well-diversified portfolios avoided over-exposure to the most volatile asset classes, which declined even more than the broad markets. This, of course, is one of the principal goals of diversification.

However, we concluded that two allocation issues warrant reconsideration in light of the recent evidence that “worst case” declines can be greater than was generally thought.

First, a portfolio designed with 60% in appreciation-oriented assets and 40% in preservation-oriented assets is widely accepted as the basis for a balanced portfolio. This does not mean that 60-40 is appropriate for every balanced portfolio; rather it means that 60-40 is a starting point from which adjustments can be made according to the specific circumstances of each investor. Pre-2008, a model 60-40 portfolio's worst one year decline was -24% (1973-1974), but this threshold was breached in 2009 with a 12 month drop of -29% for the same portfolio. By comparison, a 50-50 portfolio dropped 24% in the recent decline.

After examining the new market extremes reached in 2008-2009, we concluded that the allocation to appreciation assets in balanced portfolios should be reduced by 10% from the prior target. Thus, if the right portfolio for you, in the environment as previously understood, was 60% in appreciation assets, to achieve the protection you expected, your new target should be 50%.

(continued on page 3)

INSIDE

**Solutions for
Long Term Care**

**Financial Focus
Series**

**Schwab
Charitable™**

**Retention
Record**

**HTG
News**

SOLUTIONS FOR ...

Long Term Care

The American population is aging, and the group over 85 is now the fastest growing segment of the population. The good news is that we are living longer.

With increased longevity, however, comes the risk that at some point in our lives, many of us will need long term care. A sobering statistic is that about 60% of people over the age of 65 will require some type of long term care in their lifetime. Along with your health and family history, consider that:

- The odds of needing care increase greatly as you age
- Of those over age 85, 64% will need care at some point
- For those turning 65, 30% will need care lasting more than 2 years
- Women are at a greater risk than men, as are single people
- The average length of stay in a nursing home is 2.5 years (for those over 65)
- The average length of stay for Alzheimer's patients is 7 years
- The average length of time receiving home care is 3.3 years

Cost of Care

Costs for long term care vary around the country, and are highest in urban areas. According to The Connecticut Partnership for Long Term Care, the average rate for a semi-private room in a care facility in Connecticut in 2008 was \$327 per day. It is important to note that this cost increased by over 5% from 2007 and we can safely assume that it will continue to rise. At roughly \$330 per day or \$120,450 per year and increasing at 6% each year, in 20 years you can expect to pay half a million dollars per year for care. Over the past 10 years inflation was 2.6% which means that the cost of care is currently rising at more than twice the rate of inflation.

Cost of Long Term Care Insurance

Long term care insurance provides a way to pay for the assistance you may someday need, without depleting your assets. A couple age 60, in average health, can expect to pay approximately \$5000 per year for a joint policy that would provide \$200 per day for three years, adjusted for 5% inflation annually with a three month waiting period. Keep in mind that this policy might not cover all of the expenses. Recent research into long term care insurance confirms that purchasing coverage at or before age 60 is highly desirable because premiums increase significantly thereafter. It is also important to note that premiums are federally tax deductible.

Many people are reluctant to purchase long term care insurance because the cost can be significant and they don't want to spend money on something they might not use. They rationalize that they have enough assets to self insure and this may indeed be the case. A few of the risks to consider with self insuring are:

- Failure to achieve the asset growth levels expected
- Long term care inflation could be higher than 6% per year, thereby increasing the cost
- Your need for care may exceed the typical need of 2-4 years
- Your need for care may begin at an early age

Insuring long term care isn't just about the money. There are some real emotional and personal issues to consider. Even if you have enough assets to fund the care, the well spouse might be disturbed to see his or her nest egg being depleted significantly to cover care for an ill spouse. This has caused spouses to wonder... "Will there be anything left to take care of me?" Children may view their inheritance as being spent on care and may disagree among themselves as to how much should be spent.

Deciding how to handle the potential need for long term care is challenging. We recommend that you work with your financial advisor to determine the proper course of action to meet your goals and circumstances. ♦



Our winter Financial Focus Series encompasses the following presentations:

"All You Need to Know About Long Term Care Insurance" was presented by Steven Sheinberg of Georgetown Financial Group. Participants were provided invaluable information on the who, what, when, where and how of this complex product.

"A Woman's Guide to Financial Freedom" will take place on Tuesday, February 23rd. The program will be presented by Robin Sherwood CFP® and Barbara Ollinger CFP®. Topics to be covered include how to set financial goals, establish investment plans, capitalize on tax-advantaged retirement planning vehicles and protect assets through smart estate planning.

"Investment Strategies in Today's Environment" will be held on Tuesday, March 23rd. Tom Gnuse and Robin Sherwood CFP® will review and update basic principles that apply in these uncertain times. The discussion will focus on techniques for managing risk while achieving lifetime investment goals.

If you are interested in learning more about any of these topics and cannot attend our sessions, please let us know and we can arrange to address your interests individually.

Schwab Charitable™ Becomes 10th Largest Charity

Since its inception in 1999, Schwab Charitable™, one of the nation's largest and fastest growing donor-advised funds, has received over \$3.8 billion in philanthropic contributions and issued more than 367,000 grants totaling \$1.6 billion to over 33,000 charities throughout the country. Just as the fund observed its 10th anniversary, it was listed as the 10th largest charity in the US.

Schwab Charitable™ works with donors and their advisors to help make giving as efficient, effective and enjoyable as possible. For more information, contact HTG Investment Advisors Inc. or visit the Schwab Charitable™ website at schwabcharitable.org.

Record Retention

Papers piling up and you're unsure of what you need to keep? Here is a list of records that you should retain.

7 YEARS

- Form 1099s
- Bank deposit slips
- Bank statements
- Cancelled checks supporting tax deductions
- Charitable contribution documentation
- Credit card statements
- Receipts, diaries, logs pertaining to tax return
- Tax returns (with supporting documentation)
- W-2s

OWNERSHIP PERIOD

+ 7 YRS

- Dividend reinvestment records
- Year-end brokerage statements
- Home improvement/repair receipts & cancelled checks
- Home purchase documents
- Investment property purchase documents
- Investment purchase and sales slips
- Mutual fund annual statements

PERMANENT

- Divorce Documents
- Estate planning documents
- IRA annual reports
- IRA nondeductible contributions (Form 8606)
- Retirement plan annual reports
- Tax returns (IRS schedules)

LIFE OF POLICY + 3 YRS

- Insurance policies

TERM OF LOAN + 7 YRS

- Loans

continued from page 1

...Selecting the Course

Second, we have long been advocates of investments which are considered alternatives to traditional stocks and bonds and which have low correlations to traditional investments. These include commodity futures and investment real estate, as well as trading strategies such as merger or convertible arbitrage. In the past, many of these strategies were available primarily through hedge funds, but they are now increasingly available in mutual funds, making their inclusion in individual portfolios more feasible. For these reasons, we believe an increase in allocation to alternatives is called for, with a corresponding reduction in investments in traditional US and foreign equities.

Staying the Course

In our review, we observed that portfolios with a consistent asset allocation throughout 2008 and 2009 performed better than portfolios where significant mid-course adjustments were made. Many studies over the years have shown that most individual investors underperform the funds in which they invest by making timing decisions which detract from their returns. This result stems from a basic characteristic of human nature—over optimism when things are going well and excessive pessimism when things are going badly. Thus, investors tend to keep more invested in riskier assets when prices are high and less when prices are low. This movement back and forth between riskier and safer assets, over time, reduces portfolio returns.

To help resist the urge to sell during times of market stress, one can choose a lower initial allocation to appreciation (i.e. riskier) assets. This more conservative portfolio, if held steady through the market cycle, is likely to provide a higher overall return than starting with a more aggressive portfolio, then applying the brakes when the going gets tough.

In Summary

From our review of 2008 and 2009, we conclude that asset allocation and diversification remain powerful tools for portfolio design. However, we believe that target allocations to appreciation assets at this time should be lower than was suggested by industry practice prior to this period of new market extremes. Finally, we conclude that, having adopted a lower risk portfolio, one should strive to maintain that level of risk through market declines. ♦

- ◆ Robin Sherwood attended a two-day insurance seminar in Tampa, Florida, in February. Industry experts provided insights about current developments in the area of lower-cost life, disability and long-term care insurance.
- ◆ Tom Gnuse will attend the quarterly meeting of the DFA Greater NYC Study Group in March. He also will attend the annual meeting of the Aegis Group in the Quad Cities, Illinois in May. Both groups are comprised of owner/managers of independent advisory firms who meet to share experiences and insights regarding planning, investment and management issues.
- ◆ Tom's sister, Kit Brunson, has been helping the people of Haiti for over ten years. She is on the board of Sundouloi Ministries, a 501(c)3 organization located in Indianapolis, Indiana.

In addition to providing finance for disaster relief, school feeding programs and well drilling, Sundouloi Ministries sponsors annual women's conferences, medical clinics and youth camps, and various construction projects. For more information, visit www.smihaiti.org. If you are interested in opportunities to participate in a trip to Haiti, e-mail Kit at kit@smihaiti.org.
- ◆ Tom and Jeanne recently joined representatives of several advisory firms at a panel discussion on investment and economic topics. The guest speakers included Liz Ann Sonders, Chief Investment Strategist of Charles Schwab & Co.
- ◆ Emily Ziolkowski, Robin's oldest daughter, is now working in Berlin, Germany. For anyone who is traveling there, Emily would be happy to provide advice on what to see and do. She knows where to find good, inexpensive restaurants, too.
- ◆ Robin attended an investment workshop sponsored by Fidelity in New York in December. Discussions led by top fund managers focused on key economic issues, investment strategies, and new ways to succeed in a volatile market.
- ◆ Jennifer and Luciano Nicasio are thrilled to announce the engagement of their eldest daughter, Lauryn, to Conor Soden, both Middlebury College graduates. The wedding will be held in September 2010 in Greensboro, VT.



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