Investor Insights & Outlook

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Quick Facts: Retirement

1. According to Aon Hewitt's "The Real Deal" 2012 study, an average full-career contributing employee needs 11.0 times pay at age 65, after Social Security, to expect to have sufficient assets to last through retirement. For example, if your salary is $80,000, you will need to have accumulated $880,000 by the time you're 65 and ready to retire.

2. In reality, the same employee is expected to have only 8.8 times pay in resources at retirement, which translates into a 2.2 times pay shortfall. To reuse the example above, this means you'd be $176,000 short.

3. The 2013 Transamerica Retirement Survey found that the percentage of participants who have taken a loan from their 401(k) plan has increased from 16% in 2008/2009 to 21% in 2012, then slightly decreased to 17% in 2013.

4. Wells Fargo conducted a survey of 1,000 middle-class Americans. The study shows that across middle class members of all generations, only 24% are confident in the stock market as a place to invest for retirement. The apprehension about the market is stronger for those age 25 to 29, with 56% expressing fear of losing their nest egg. When asked if given $5,000 for retirement where they would invest, 58% of those age 25 to 29 said they would invest in a savings account/CD.

5. Only 18% of workers are very confident they will have enough money to live comfortably in retirement (according to the EBRI 2014 Retirement Confidence Survey).

Sources: Aon Hewitt's "The Real Deal: 2012 Retirement Income Adequacy at Large Companies." "14th Annual Transamerica Retirement Survey of American Workers," Transamerica Center for Retirement Studies, July 2013. Wells Fargo news release, "Middle Class Americans Face a Retirement Shutdown," October 2013.

BR Capital inc.

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Advisors Corner

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They provide the morning and afternoon market reports and financial commentary for AM 1360 KUIK. Articles and interviews are available at http://brcapitalinc.com.

The Great Yield Chase

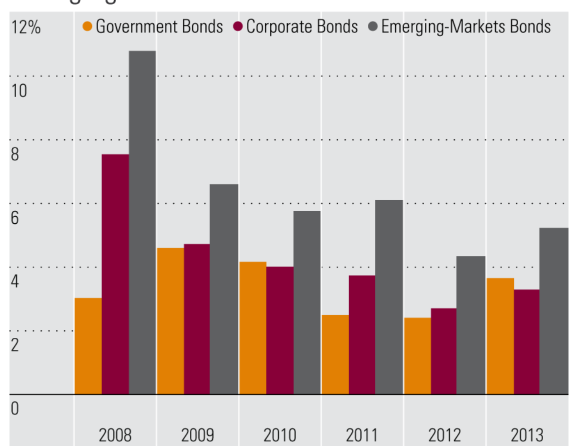
With Treasury yields still relatively low and worry about the eventuality of rising rates ever present, many investors have been moving away from Treasuries and into other fixed-income sectors in their quest for income. Two fixed-income segments seeing activity from this migration are corporate and emerging-markets bonds.

Corporate bonds: Many investors have bumped up their allocations to corporate bonds for reasons that are pretty straightforward. Company balance sheets are about as healthy as they've been for many years, with cash holdings high and default rates at multiyear lows. In addition to these attractive fundamentals, buying has been strongly encouraged by central bank policies, including the Federal Reserve's quantitative-easing programs. They have played a major role in suppressing agency mortgage and Treasury yields, which in turn has pushed investors to take on more credit risk in search of more yield.

Emerging-markets bonds: The trend of holding emerging-markets bonds has gained popularity in recent years. Again, investors have been given incentive to hold higher-risk assets because developed-markets central bank policies have pushed Treasury yields down. A byproduct of these central-bank policies is that assets have not only poured into U.S.-based investments but also into emerging-markets bonds of all kinds, including both sovereign and corporate sectors. Further boosting their attractiveness, emerging-markets credit ratings have been rising based on a number of factors, including economic structural reforms and growth rates that are meaningfully higher than in developed markets. To top it off, the underlying balance sheets of many emerging economies look increasingly appealing when compared with the debt-laden, major economies of the West.

With greater return potential comes greater risk. The ultimate questions for investors moving out of Treasuries are whether their investment alternatives will stand up to potential trouble down the road and whether their portfolios still line up with their risk and return expectations. There's a tension between trying to provide the best possible returns when things are going well and maintaining the kind of portfolio that should provide better diversification in the case of volatile equity markets. In recent years, investor demand has significantly pushed prices up and yields down. Those new lower yield levels suggest that, even under the best circumstances, the prospect for future returns is muted. While currently attractive, there's reason to be wary of how these sectors will perform under stress scenarios. Most investors aren't expecting a repeat of 2008, when Treasuries rallied and risky assets sold off, but it's nearly certain that bumps in the road will appear at some point. It is important to be aware that a dearth of yield may be causing some investors to take on more risk than they realize.

Yields for Government, Corporate and Emerging-Markets Bonds



Diversification does not eliminate the risk of experiencing investment losses. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest. With corporate bonds, an investor is a creditor of the corporation and the bond is subject to default risk. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, and differences in accounting and financial standards. Emerging-markets debt carries unique risks and may not be suitable for certain investors. Emerging-markets investments are more risky than developed-markets investments.

Data: Government bonds—20-year U.S. government bond; Corporate bonds—Barclays U.S. Corporate Investment-Grade Index; Emerging-markets bonds—Barclays Emerging Markets Aggregate Index.

Monthly Market Commentary

So far, it's been a chilly spring for the economy. Growth in most U.S. metrics has been slow for three months or longer. Some of that stagnation is weather-related, but certainly not all. Factors such as the government shutdown and budget settlement, major inventory build-ups, and higher interest rates have all been negatives for recent economic activity.

Federal Reserve News: The Federal Reserve policy statement, economic forecast, and press conference on March 18-19 didn't really tell markets much that they didn't already know. Much emphasis was placed on Fed Chairwoman Janet Yellen's comment that rates could begin to be raised as soon as six months after the bond-buying program was completely wrapped up. Irrespective of when, one thing's for certain: rates are going higher and investors will have to learn to live with it. However, unless the economy picks up a little steam soon, the Fed may not feel nearly as aggressive a month or two from now.

Housing: Existing-home sales fell from an annualized 4.62 million units in January to 4.6 million units in February. That is after a giant swoon between July 2013, when existing-home sales peaked at 5.38 million units, and the most recent 4.6 million level. A drop of 14% in unit sales in the middle of a recovery is more than a little disconcerting. In terms of total dollar values transacted, the market is down 20% from its July peak. Similar to the existing-home data, monthly housing starts changed little from January to February after several months of decline, perhaps indicating that the bottom is in, which would be a welcome relief. Data for housing permits looked better, but most of the improvement came from multifamily homes, which tend to be less expensive and add less to GDP growth.

Inflation: The headline inflation number for consumers looked great on a top-line basis. Month-to-month prices were up just 0.1%, and an amazingly low 1.1% when comparing February of this year with February of last year. However, the categories that were up are truly important to consumers. Grocery prices were up 0.5%, airline fares 1.3%, and drugs 0.9% after showing almost no growth in 2013. Holding back price increases was gasoline (down 1.7%). That was a bit of a mirage, though, as bad weather delayed normal refinery shutdowns from February to March.

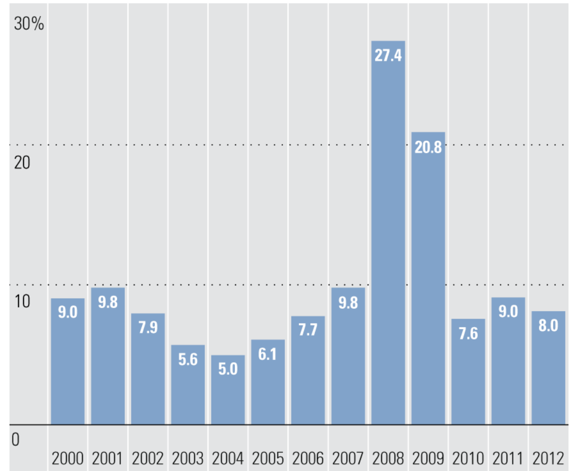
GDP: The estimate of GDP growth in the fourth quarter of 2013 was bumped up modestly from 2.4% to 2.6% at an annualized quarter-over-quarter basis. The more representative full-year growth rate for 2013 was unchanged at 1.9%. Interestingly, both the annualized sequential growth rate and the fourth-quarter-to-fourth-quarter growth rate are now equal, at 2.6%. So it would appear that the economy's true GDP growth rate lies somewhere between the bounds of 1.9% and 2.6%. A meaningful shrinkage in the government sector just about cancelled an unusually large (and not sustainable) increase in exports. Business spending picked up some but not a lot, and residential investment was a net detractor from GDP growth for the first time since 2010.

Quarter-End Insights: The U.S. economic data has shown signs of weakening for the past three months running, despite some real optimism that developed in the fourth quarter of 2013. That optimism was based on the end to the fiscal stalemate in Washington in October, a 4.1% GDP growth rate in the third quarter, and a 3.2% estimated growth rate in the fourth quarter (later revised down to only 2.4%). Sky-high retail sales data that was subsequently revised sharply downward also contributed to economists' bright mood at the end of 2013. However, poor weather seems to have interrupted the upward trajectory. The effects of abnormally cold and snowy weather seem real, but the weather is not the only cause for the recent weakness. Parts of the economy, including the housing sector, were already showing some slowing even before the cold weather arrived.

Dividend Income: Not So Fixed

Since interest rates are still relatively low right now, many investors looking for income and yield have begun to assess switching a portion of their investment allocation from bonds into dividend-paying stocks. However, it is important to remember that the interest payment of a bond is a contractual obligation of the company, whereas dividend payments are not. If a bond issuer does not pay either interest or principal on time, the company will be in default, and likely will be placed into bankruptcy. However, dividend payments are not a contractual obligation of a company and can be either cut or raised by its board of directors at will. When times are tough, companies may cut dividends to conserve cash, such as during the 2008 credit crisis. Conversely, when times are good, companies may increase their dividend payments, providing investors with additional upside.

Percentage of Companies That Cut Dividends



Source: Morningstar analysis. This is for illustrative purposes only and not indicative of any investment. Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed, and stocks have been more volatile than bonds. Dividends are not guaranteed and are paid solely at a company's discretion. Percentage of companies that cut dividends is calculated for listed companies on NYSE, NASDAQ, and NYSE AMEX.

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