KAMP inSITE

Fireside Chat

Kamp Consulting Solutions, LLC

Your Monthly Update from KCS

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Inside This Issue

Good Markets…Bad Behaviors?

How quickly we forget!

Less than five years ago, investors were reeling from the Global Financial Crisis of 2008, considered by many economists to be the worst financial crisis since the Great Depression of the 1930s. Large financial institutions were threatened by collapse, banks were bailed out by national governments, and stock markets were pummeled around the world. In many areas, housing markets also suffered, with the crisis playing a significant role in reducing consumer wealth by trillions of U.S. dollars. The downturn in economic activity lead to the 2008–2012 global recession and contributed to the European sovereign-debt crisis, which may still play out in the coming years.

The resulting crisis became acute in September 2008, ushering in a period of unusual market volatility as measured by the S&P 500 Index, encompassing record 100-point moves in both directions and reaching its highest levels since 1929. On 11/20/08, the index closed at 752.44, its lowest since early 1997. A modest recovery the following day still left the index down 45.5% for the year. This year-to-date loss was the greatest since 1931, when the broad market declined more than 50%; the total losses that ushered in the Great Depression exceeded 80% over a three-year period. The market continued to decline between late 2008 and early 2009, reaching a nearly 13-year closing low at 676.53 on 3/9/09.

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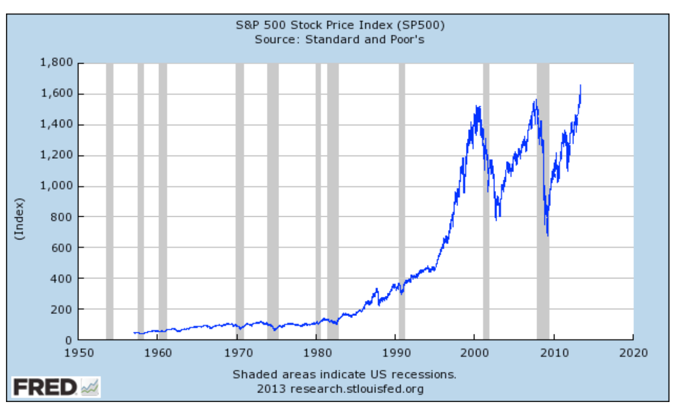

On 3/23/09, the S&P 500 hit 822.92, marking a 20% gain. Although the markets continued to experience significant volatility amid electoral

Good Markets…Bad Behaviors (cont'd)

and fiscal uncertainty, gains continued, and the 2012 close of the S&P 500 following QE3 was its third-highest ever, at 1,426.22 points. Fast forward to May 2013. On 5/3/13, more than thirteen years since its first close above 1,500, the S&P 500 closed above 1,600 for the first time, at 1,614.42. It reached its highest close of 1,669.16 on 5/21/13.

"A combination of investment gains and worker contributions have helped push the average amount saved in a 401(k) to its highest level ever by the end of 2012…But the average, while 12% higher than a year earlier, totals just $77,300, according to Fidelity's data, which covers 12 million participants."

With markets reaching these all-time highs, one would think that both individual and institutional investors would benefit and feel a sense of relief. Unfortunately, short-term memory lapses may cause some investors to make questionable decisions again.

False Wealth

As of May 30, 2013, the S&P 500 index has returned 16.0% YTD (price basis) and 26.3% for the one-year period. A combination of investment gains and worker contributions helped push the average amount saved in a 401(k) to its highest level ever by the end of 2012, according to the latest Fidelity Investments analysis of the retirement-savings plans it manages. But the average, while 12% higher than a year earlier, totals just $77,300, according to Fidelity's data, which covers 12 million participants. That is a fairly dismal sign that there are some difficult retirement years ahead for many savers.

While most retirees may require more than $77,000 for living expenses during retirement, some participants are considering cutting back on their contribution rate. They are forgetting about the past market volatility and are seeing increased wealth on paper due to recent market gains. Some are using the money that would have been contributed to their defined contribution plan for other expenses or purchases. It is important for plan participants to stay focused on their long-term investment goals during all market conditions.

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All the Wrong Moves?

One of the biggest concerns about individuals bearing the responsibility of handling their own retirement is related to asset allocation. For many participants, their knee-jerk reaction is to sell after the market corrects and buy near the top of a market cycle after the asset class has generated outsized gains. It is very difficult for investment professionals to be contrarian in the allocation process, let alone an untrained plan participant.

Unfortunately, this phenomenon has reared its ugly head during the latest market rally. Spectrem Group has reported that the average

All the Wrong Moves? (cont'd)

allocation to equities was less than 50% as of year-end 2012, down from 59% as of year-end 2006. This despite the fact that the S&P 500 index return has more than doubled since its low in March 2009. Clearly, many participants were reluctant to get back into equities following the 2007-2009 correction.

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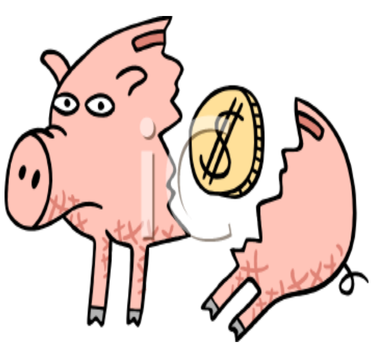
Compounding the problem associated with lower equity exposure is the allocation to stable value products, which represents roughly 21% of all defined contribution assets. Given the low interest rate environment, these stable value funds provide little upside potential to enhance the average 401(k) balance. We believe that plan participants need a long-term time horizon for the asset allocation process, and short-term corrections should be used to rebalance the portfolio to one's asset class targets. One may be able to use target date funds to accomplish this goal; however, as we discussed in a previous *Fireside Chat* (December 2012), these products also have some features that may need closer scrutiny.

It's not a Bank Account



Another phenomenon of rising account balances and the perception of an improving economy is that participants want to tap some of their available account balances before retirement. In some cases, it is inevitable. Some scenarios include paying unforeseen medical expenses, education costs for children or to prevent home foreclosure. However, some participants feel that after years of "struggles", they are entitled to a treat such as a dream vacation or a splurge purchase funded by the additional wealth the recent market rises have provided. If a sponsor has a general purpose loan policy, these loan types are available to participants, but may not be in their best interests long-term.

Wells Fargo recently announced that in the fourth quarter of 2012, participants enrolled in plans they administer had a 28 percent increase in the number of loans taken from their 401(k) accounts and that the average new loan balances increased to $7,126 from those taken out in the fourth quarter of 2011 - a 7% increase from $6,662.

Of the participants who took out loans, the greatest percentage were to people in their 50s (34.2%), followed by those in their 60s (28.9%) and then by those in their 40s (27.3%). The increase among participants in their 50s was nearly double the increase among those under 30. This is based on an analysis of a subset of 1.9 million eligible participants in retirement plans that Wells Fargo administers.

It's not a Bank Account (cont'd)

The increased loan activity among older participants (>63%) is particularly disconcerting. As one enters their 50s, the IRS has enabled participants to make "catch-up" contributions to their accounts. By increasing loan activity, it appears to us that they are denying themselves an opportunity to increase their balances through these additional contributions and the compounding of returns on their current balances. We understand that financial demands on the 40+ crowd often stem from support for both their parents and children. However, if they don't take care of their retirement needs, it is unlikely that anyone else will!

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Taking Your Lumps

Another potential bad behavior relates to the transfer of 401(k) balances upon termination of employment, either voluntary or involuntary. If the plan participant has a balance of more than $5,000, defined contribution plan regulations allow for that individual to maintain their account at the sponsor organization from which they are departing. Unfortunately, many plan participants are unaware of this feature and often take premature lump sum distributions, which we've previously discussed in the September 2012 *Fireside Chat*. These lump sum distributions are frequently not transitioned to the new employer, and not just because they might not offer a defined contribution plan.

In an April 29, 2013 story published by Reuters, it was reported that the U.S. Government Accountability Office confirmed what's already been quietly discussed at the Consumer Financial Protection Bureau: Some plan service providers (the people who man the 401(k) plan advice telephone lines for employers) steer workers away from 401(k) plans and toward privately owned IRAs the service companies sell. Sometimes, they go so far as to mislead those workers along the way.

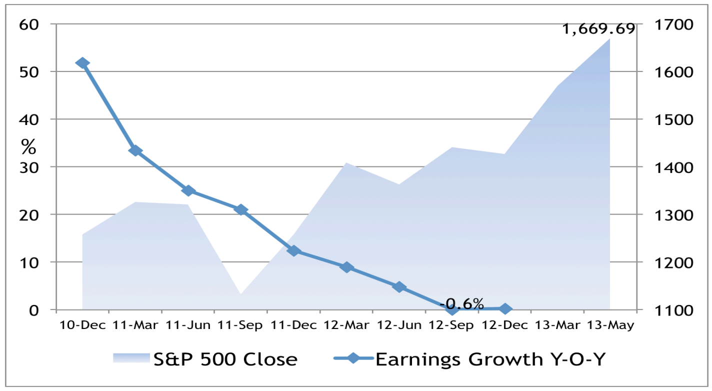
"In many cases, workers would be better off leaving the money in the 401 (k) plan, where the fees are often constrained and investments are pre-screened and evaluated on a fairly regular basis."

The GAO had an investigator pretend to be a somewhat clueless employee getting ready to change jobs and call 401(k) plan service providers to ask questions about what to do with his plan. He called 30 different service providers and several pushed him away from the 401(k) plan to the IRA.

Unfortunately, many workers don't really understand the implications of their decisions. In many cases, workers would be better off leaving the money in the 401(k) plan, where fees are often constrained and investments are pre-screened and evaluated on a fairly regular basis.

Whoa Nellie!

As we've discussed, there are multiple bad behaviors perpetrated by defined contribution participants. We are concerned about each, but we are particularly frightened by the prospect of participants chasing the "hot" fund or asset class after the horse has left the barn.



"…we'd suggest that the markets have been driven by the hope that perceived liquidity infusions by the U. S. Federal Reserve would create economic activity, growth, and inflation."

As the chart above reveals, U.S. equities, as measured by the S&P 500, have continued to roar ahead, even in an environment when year-over-year corporate earnings growth for the S&P 500 companies has been falling precipitously.

We'd ask, is the recent rise in the price of the S&P 500 supported by the fundamentals? Based on this chart, we'd suggest that the markets have been driven by the *hope* that perceived liquidity infusions (QE1, QE2, and QE3) by the U.S. Federal Reserve would create economic activity, growth, and inflation. Unfortunately, as reported today, May 30, 2013, first quarter GDP was revised down to 2.4%, initial unemployment claims were up 10,000, marking the third rise in the last four reports, and finally, U.S. corporate profits fell in the first quarter relative to the fourth quarter of 2012.

Keep focused on your long-term asset mix, and don't allow short-term momentum to persuade you to overturn your plan. We've recently heard talk about a new "paradigm" for U.S. equities. Haven't we been down this road before?

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