Ranstrom Financial Planning Services, LLC
808 3rd Ave S Ste. 420, Fargo, ND 58103

Doyle A. Ranstrom, MS, CFP®
Ryan S. Berg, CPA, CFP®, PFS
Courtney E. Ranstrom, MBA, CFP®

Thoughts and Comments — Spring 2013

Occasionally, I am asked one of two questions. One is, "When are you going to retire?" The other is "If you are so good at this, why haven't you retired?" Since both are fair questions, I want to address them.

As to the first, I enjoy what I do and have no plans to retire. I read somewhere that the key to a successful business is to surround oneself with bright, talented individuals who are committed to the very highest professional standards. I certainly have done this and it makes work both challenging and enjoyable. I often tell Kim that I am around for my rugged good looks and pleasing personality. She just shakes her head and walks away.

Regarding the second, I have been very fortunate and can retire any time I want. We may not have the same income as when I was working, but we would be comfortable. However, Kim and I may have to embrace one of the foundations of financial planning which is – buying something on sale is not saving money, it is just spending less.

When retirement does happen, like the majority of our clients who are already retired or looking forward to retirement at some point in the future, a substantial share of our retirement income will come from our retirement portfolio. We work with a number of clients who since we started working together were first in the pre-retirement accumulation phase, then the transition phase, and finally full retirement at which time they live off their various sources of retirement income. At some point, I will have gone through all those phases. I never worry about my Portfolio's current or future ability to generate a retirement income for us for several reasons. I will be 62 this summer and I started in the financial services industry when I was 27 which means I have been in the financial services industry for over 35 years. At this point, there is very little that phases me, especially short-term economic or political events. I have had and continue to have a strong optimism in capitalism, long-term global growth, and the potential for a diversified portfolio to grow and generate income over a long period of time. (As a side note, 35 years looks like a long period of time when it is written out like this.)

Though we have clients who wish to be aggressive and we have an aggressive asset allocation model, our Unconstrained Spectrum Model, our core model, the Global Spectrum Model, as one would expect, matches my investment philosophy. Since the early 1990s my philosophy has been to be diversified utilizing a wide variety of asset classes and investments in the Portfolio. Volatility is normal and to be expected in any investment, but in my estimation, less volatility is better. While this may reduce return in a rising stock market, it can also reduce decline in a down stock market. Though there are no guarantees for the future, on a long-term basis we believe reduced volatility enhances long-term return. Our goal is not to match the stock market or any one asset class, but to provide a real return over an entire market cycle.

A real return is return in excess of inflation. In other words, a portfolio that has a real return not only maintains, but increases buying power. I am much more concerned about loss of buying power over a long-term time period as opposed to short-term volatility. For example, using the Consumer Price Index from 1974-1983, a time period of high inflation, a dollar lost 67% of its purchasing power. By comparison, from 2000-2009, a time period of low inflation rates, a dollar lost about 20% of its purchasing power. Many believe, and I agree, we are moving into a period of higher inflation rates.

(701) 293-5789
Toll Free: (888) 293-5789
Fax: (701) 293-0331
www.ranstrom.com
doyle@ranstrom.com
ryan@ranstrom.com
courtney@ranstrom.com

There are and always have been a lot of risks for investors. A volatile stock market is one. Another risk is rising interest rates and if that happens how that affects various parts of the bond market. Commodity and currency prices are other risks to name just a few. And, with all risks come opportunities. For example, the volatility risk in the global stock market has led to opportunities, especially in specific areas. In all of our models, we try to balance risk with rewards.

So, how does this all fit together?

- I have a Portfolio that is diversified and has the potential for a real return but does not have the risk of a high concentration in one investment or asset class.
- If myself or any client decides to retire tomorrow, there is a significant allocation in low risk investments and investments with a low correlation to the stock market from which I can draw income for years without worrying about stock market volatility.
- If the stock market continues to increase, the model will benefit. In addition, we invested in parts of the global stock market at low prices compared to previous highs.
- If the stock market should become volatile, there are hedges in place which can reduce volatility. In addition, we can change our allocation very quickly.
- The net result is that during the first quarter the Global Spectrum Model had a positive return in all five allocation groups with a total gain of about 3%. Though there are no guarantees for the future, we will try to build on this gain in subsequent quarters while at the same time striving to avoid high volatility which can affect long-term total return.

For me personally, the Global Spectrum Model's objectives and allocation meet my needs while I am in the accumulation phase and at some point in the future, the distribution phase. I will continue to try and make a significant contribution to our firm with my combination of rugged good looks, pleasing personality, and long-term perspective.

Ryan's Update

Ryan will return next quarter with an update. We gave him the quarter off as he is busy in the final days of tax season.

"How much can I withdraw?" from Courtney

In our Summer 2012 Thoughts and Comments, I wrote about the question I frequently hear from younger investors – "How much should I save?" Conversely, the question I hear from our clients who are either retired or transitioning to retirement is "How much can I withdraw?" Withdrawing money from your Portfolio at retirement can be a bit surreal. You have spent years accumulating assets – going from accumulating to withdrawing requires a complete change in thinking. It's important to remember that the years you spent working hard and saving were so that you could use the money in retirement to support your lifestyle and enjoy what we hope are fulfilling years.

There are several different distribution options from a Portfolio at retirement including income only, fixed period or life income annuity from an insurance company, living benefits rider, also from an insurance company, and systematic withdrawal which we call Rate of Withdrawal (ROW). We are familiar with the different types of distribution options; however, Rate of Withdrawal is the option we generally recommend. It has worked well for our clients over the years and believe it will continue to do so. ROW is calculated by dividing your annual withdrawals by your totals assets. As a general rule, we encourage our clients to maintain an annual rate of withdrawal of 5% or less. When withdrawing assets, the goal is to withdraw less than your assets earn over an extended time period so that your principal balance grows over time.

That is not to say that you can't take out more in a given year. Below is an illustration of different rates of withdrawal. For illustration purposes, the rate of return (ROR) stays the same at 6%. Actual rates of return may vary from the below illustration.

	3% ROW	4% ROW	5% ROW	6% ROW	7% ROW	8% ROW
Beginning Market Value	$500,000	$500,000	$500,000	$500,000	$500,000	$500,000
Rate of Return (ROR)	**6%**	**6%**	**6%**	**6%**	**6%**	**6%**
Projected Annual Earnings	$30,000	$30,000	$30,000	$30,000	$30,000	$30,000
Rate of Withdrawal (ROW)	**3%**	**4%**	**5%**	**6%**	**7%**	**8%**
Annual Withdrawal	-$15,000	-$20,000	-$25,000	-$30,000	-$35,000	-$40,000
Projected Year End Value	**$515,000**	**$510,000**	**$505,000**	**$500,000**	**$495,000**	**$490,000**

As you can see, using an ROW less than the ROR allows the principal balance to grow over time. Withdrawing more than the Portfolio earns in a year reduces the principal balance. While withdrawing less does not guarantee the success of your Portfolio, it increases the probability that the money will last throughout retirement. In addition, adding to your principal balance in the early years of retirement can allow for greater withdrawals in your later years of retirement where you may incur increased costs such as health care and assisted living.

As you think about your cash flow needs, we want to make sure you have enough. Just like with saving during your accumulation years, you need to find balance. Your rate of withdrawal does not need to be a static number – some years you may need more and some years you may need less. In either case, we will work with you to balance your current cash flow needs with the longer term goals of your Portfolio.

Investment Update from Morgan

As I look around the investment world at quarter's end, it strikes me that investors are by and large fighting yesterday's wars. I suppose this is a part of human nature; however, our herd mentality, something that was most likely of significant benefit when a few 'first-responders' started running at the site of a hungry saber tooth tiger, does not serve us in the investment arena. What begins as a good (and profitable) idea slowly transforms itself into a very bad investment as more and more money pours in. In contrast, a cheap stock or bond can almost be painful to invest in after the precipitous fall that took it to such levels. This is why study after study seems to confirm that value investing, investing in stocks and bonds when they are cheap according to various indicators, outperforms larger market indices over long periods of time – investors tend to chase returns, while ignoring value. (Sidenote: My personal favorite book on the topic is *Value Investing: Tools and Techniques for Intelligent Investment* by James Montier. It's chock-full of quantitative studies on the matter).

For example, even as gold prices peaked in September 2011, total net assets of a popular ETF that tracks gold prices did not peak until September 2012 after $11 billion in additional fund flows. In other words, investment followed past performance and has been sorely disappointing to date given the fact that current prices are off almost 20% since the 2011 peak. One could relate this to the Tech Bubble of the late 90s, the housing bubble of '03-'07, or countless investment follies over the past few centuries. Isaac Newton is attributed with the following quote after he was reported to have lost £20,000 in the epic South Sea Company (the equivalent of over £2.4 million in present day terms): "I can calculate the motion of heavenly bodies but not the madness of men."[1]

Bubble spotting is a hard business, and I make no claims of total prescience. However, a good place to start looking is investor fund flows. Over the past year, over $70 billion dollars has flowed into the emerg-

[1] "South Sea Company," last modified March 2, 2013, http://en.wikipedia.org/wiki/South_Sea_Company.

ing market equity asset class according to Morningstar.[2] An additional $76 billion flowed into emerging markets fixed income. Also, $81 billion flowed into high yield fixed income, and a staggering $256 billion flowed into US fixed income funds. As a personal anecdote, I receive many calls from fund companies and the #1 asset class everyone was pushing in late 2011-2012 was emerging market bonds. In my opinion, this is usually a good sign to get while the gettin's good (and we have)!

To contrast with the above numbers, the Europe equity large-cap asset class received only about $9 billion while the worst performer (by fund flows) was US equity large-cap growth, losing a whopping $37.9 billion in fund flows!

To put all of this in context, since 2009 US stocks have been in what is arguably the most hated and underappreciated bull market in history and investors continue to pull money out. In contrast, the math has never been worse for bonds given historically low interest rates and tight credit spreads in high yield and emerging market credit. However, emerging market fixed income and high yield fixed income rank #7 and #11 respectively on 2013 fund flows. Lastly, you would have difficulties finding more than a handful of investors bullish on European Monetary Union equities. We just happen to be one of them, and as I look around I cannot find a large asset class more hated. For example, both Spanish and Italian equities are cheaper than they were on January 1st, 2009, a time when many believed the global financial system as we knew it would soon cease to exist. Though the region certainly has its economic difficulties, we see a multitude of positive developments. Though there are no guarantees, generally the best time to invest in equities is during a recession when things look most bleak. Over time, we believe the market will come to see our point-of-view, though in the short-term we suspect things will remain quite volatile.

To sum, we look negatively upon bonds of all stripes, believing investors are chasing the extraordinary returns of the past thirty years. We also believe investors have wrongly bought into the myth that emerging markets (and especially China) will continue to grow indefinitely without a credit cycle or recession to blotch their record. Coincidently, if they did succeed in this endeavor it would be the first time in history a country or group of countries has risen above the business cycle. Many economists thought the US had entered a great plateau of never-ending economic growth during the 1990s and early 2000s. 2007-2009 crushed such fairy tales and we believe a more tempered viewpoint will win out in emerging markets as well. We favor domestic and European equities as well as alternative assets and alternative bond strategies which we believe have the opportunity to profit amidst a long-term rising interest rate environment, while still serving the traditional bond purpose of portfolio diversification and volatility reduction.

Generally, I do not write so directly about our outlook. However, given the fact that since December all of our models have seen drastic changes in allocation I thought this would be an opportune moment to discuss our general thoughts on allocation in the current environment. The financial industry has by and large developed to sell yesterday's best ideas as it is usually easy to sell what has already worked. However, any advisor would be remiss to confuse such mindless crowd following with service to their clients. Fighting the masses is difficult at times, but we believe that over the long-term contrarian, value investing creates true value for those who follow its tenets.

[2] Information available upon request.