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

Thoughts and Comments

Summer 2012

The third week in June I did a bicycle tour from Seattle, WA, to Missoula, MT. Though the scenery was amazing, it was one of the most challenging weeks of bicycling I have ever done for several reasons. We rode 610 miles in 7 days, we had several very difficult climbs over mountain passes, and most every day we had either a headwind or a very strong crosswind. With all that, it was still fun, similar to hitting one's thumb with a hammer because it feels so good to have the pain go away. One of the things I enjoy most about a bicycle tour is the serenity which comes from no television, radio, or internet for a week.

One of the quotes I love is from Frank Zappa's song *Packard Goose* – "Information is not knowledge. Knowledge is not wisdom." In today's world, we are bombarded by information which is often misleading or misrepresents the facts. The internet, talk radio, and cable television provide us with continual information, some accurate, much of it not. Since it would not be profitable for a daily program to say "the world, or a specific part of the world, is in good shape, check back with us in a month," they must present an alarming sensationalist perspective. That is one of the reasons I never listen to what is often considered to be talk radio or television. I only listen to programs which have credentialed academics in a specific field, journalists with direct experience (for example, a journalist who has spent time covering a war in a militarized-zone), experienced professionals in their specific field, or an author with credentials who has researched a specific subject or time period and strives to present a historical analysis. I may or may not agree with them, but as long as I can learn from them I find it interesting and informative.

In our office, each of us partners has a variety of sources for information on financial planning, current market conditions, and short term and long term economic trends. For example, Morgan reads and reviews a variety of blogs and newsletters written by economists, fund managers, and financial analysts. We often forward particularly interesting or pertinent articles or commentaries to each other. Frequently, there are conflicting opinions and viewpoints. This is not bad, but very good. In today's polarized world, individuals often just read or listen to viewpoints with which they agree. This is not beneficial and can often be harmful, both in terms of outlook and personal stress.

We obtain information from a variety of credible sources and knowledge from credentialed and/or experienced professionals in their fields. From there, we strive to determine the best strategy for both long term financial planning and money management. We have been doing this for many years and with partners age 37, 30 and 27, none of whom are me, we look forward to continuing for many more years.

Investment Update from Morgan

As I meditated on what to write for this quarter's Thoughts & Comments, I found myself thinking about compound interest and what that means in regards to risk tolerance and risk taking in the financial markets. Clearly thinking outside the box, I figured I should find a quote about compound interest to start off my literary ruminations. So I googled 'compound interest quotes' and quickly found a few different thoughts attributed to Einstein. Among them: "Compound interest is the eighth wonder of

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

the world. He who understands it, earns it ... he who doesn't ... pays it." And, "compound interest is the most powerful force in the universe." This was great stuff. Unfortunately, I also found a website which showed that Einstein probably never actually said this; rather, the quotes were an urban legend of sorts. I mentioned this to my father, and he responded, "didn't Benjamin Franklin say that?" Finally realizing the game that our culture was playing, I understood that the correct answer to his question was, 'yes.' In fact, I now believe that anybody who was awesome said some variation of this quote about compound interest. For example, Abraham Lincoln? Yes. Gandhi? Yup! Johnny Cash? Absolutely. Michael Jordan? No lyin'… Yes!

I suppose the real question then is why would our cultural heroes say such things? (Or rather, why would we make our cultural heroes say such things?) Compound interest is the ability to earn interest on past accumulated interest. With debt, this works against you. In investing, this works for you. For example, a 5% return compounded over ten years is not the 50% you would get from simple addition, but 62.9%. Over twenty years it compounds to a 165.3% total return. That ain't bad, but the discussion we have found ourselves having internally is what does this have to do with risk?

Depending on the timeframe used, domestic large cap equities have delivered nominal returns between 10.6-11.2% annually since the early 20th century (Damodaran 2012). However, as of the end of 2011, equities have only had an annual total return of 4.93% over the past decade as measured by the S&P 500 Index (Note: You cannot invest directly in an index). (Damodaran 2012) If we extended the time period back to the bubble years of 1999-2000 the picture would look even starker.

Here's the point: markets go up and down (a fact that Wall Street and most equity strategists still seem to be in denial about). To more fully capitalize on the amazing effects of compounding interest, we believe a well-managed tactical allocation approach can improve on traditional long-term buy-and-hold. In fact, though volatility is unavoidable, our investment philosophy is to limit downside volatility when we believe global market and economic risk outweighs potential rewards. On the flipside, when markets turn to the upside, reduced downside volatility allows the ability to take on less risk for competitive long-term returns (5-10 year cycles).

For example, a 30% loss demands a 43% return to break-even. Correspondingly, a 15% loss only demands a 17.6% return. In other words, losses compound just as much as gains and "the most powerful force in the universe" can indeed work against you. It is for this reason that we put risk management at the forefront of our investment process. As you might expect given this mentality, we will most likely not keep up during large risk rallies; however, by reducing losses during down trends our goal is competitive returns over a full market cycle (5-10 years) while significantly reducing risk.

Risk versus Return from Ryan

Throughout the years I have gone over many investor questionnaires with clients. These questionnaires attempt (among other things) to determine both what their risk-reward tolerance is and what type of asset allocation may be suitable for them. In almost all the questionnaires I have used the following two questions for clients to answer:

1. What is your tolerance for risk?

    a. None
    b. Low
    c. Moderate
    d. High

2. To meet my financial goals, my investments must grow at the following rate of return per year:

    a. 3% - 4%
    b. 4% - 6%
    c. 6% - 8%
    d. 8% - 10%

I am amazed how many potential clients answer the first question with the answer 'Low' (risk tolerance) and subsequently answer the second question '8% - 10%' (high returns). When quickly filling out a required form, many people's gut reaction is to instinctively want the greatest potential return, combined with the lowest risk possible. It is not until we go over this form with clients and read it back that they realize the dichotomy between their two answers. Specifically, it is not until we say to the client "So, you want us to take as little risk as possible for the greatest possible return?" that the light bulb above their head turns on.

The financial community refers to three-month US Treasury Bills when discussing the theoretical 'risk-free return.' In theory, the US T-Bill has virtually no risk of loss. This 'risk-free return' currently offers investors a 0.10% rate of return. The 10-year Treasury Bond is currently yielding only 1.62%.

There can be very good tactical reasons for holding a large percentage of low risk assets in a portfolio at any given time. But to achieve greater long-term returns, investors must be willing to increase the relative risk in their portfolios. This relative risk can come from many different asset classes, including many different types of stocks, bonds, alternative investments, managed futures, commodities, etc. This type of balanced portfolio will certainly cause some periods with negative returns, but over the long-term, a balanced portfolio strives for greater return over investing solely in minimal risk assets.

"How much should I save?" from Courtney

When I talk to our younger clients or first-time investors, the most common question I hear is, "How much do I need to save?" It's an excellent question and one that has a seemingly endless amount of answers. For younger investors, there is a certain amount of trepidation when talking about retirement and given what the last 10 years have looked like, I'm not surprised. When I graduated from college in 2002, we were in the midst of a market downturn. Thankfully, I was off to graduate school, cocooned for a few more years in higher education. When I received my MBA in 2005, I headed out into the workforce. It took a little while to find a job, but I was happy to start my career as an internal auditor for Oregon's Department of Human Services (even though I was one of the lowest paid people out of my graduating class since I chose to work in government rather than the private sector). Things were looking good until the initial shock of that first student loan payment. I made a quick review of my budget and started to wonder – How am I going to be able to pay off my loans quickly, buy a house, and save for retirement? If you recall, home prices had already started their rapid upward trajectory. I was beginning to wonder if there would be anything left in my price range. People were telling me to buy, "Home prices will only go up – this is a great time." But, I resisted knowing what goes up must come down. For the first time in my life, I was willing to be patient. In early 2007, I made a career change and started working as an internal auditor for West Coast Bank. When I started at the bank, the share price was over $40/share. And then, the real estate bubble burst, the credit markets froze up, and the market dropped. When I left the bank in February 2009 to join Ranstrom Financial Planning, the bank's share price was less than $5/share. I watched many people, particularly in the lending department, go through lay-offs. The mood was sour, even on good days.

You may be wondering where I'm going with the above and my point is this – the last 10 years have been a wild ride filled with well-documented highs and lows. While I don't expect the volatility to change any time soon, I am impressed with my generation's willingness to adapt. Working with my peers is always a treat because many already understand the importance of setting aside money now. You would think we would be a jaded bunch given how the first 10 years of our professional lives have gone, but I've been finding just the opposite is true. We are cautiously optimistic, knowing that we control our futures.

So, back to the original question – "How much do I need to save?" First, this is dependent on lifestyle – the more you want to spend in retirement, the more you will need to save. Second, how much debt will you have during retirement? Paying off your mortgage and any other debt prior to retiring will lower your fixed expenses and may allow you more freedom in your budget. Third, we need to review your retirement sources of income. Many people in my generation will not have pensions and Social Security is looked at with skepticism. Finally, how much can you save right now?

I think it's important to find balance in your life – saving for your future needs to be a priority but allow yourself to enjoy some of the fruits of your labor now. I understand that saving for retirement is intimidating and some feel that if they can only save a little bit, they might as well not save. Nothing could be further from the truth. Start small — $50 or $100 per month. You will be amazed at how quickly it can add up. Watching your account balance grow over time, because of your hard work and effort put into saving, is incredibly rewarding. We will be there to help you build a budget, stick to a savings plan, and develop an investment strategy that meets your goals.