

Delivering the Wrong Message

Most of us consider television commercials an annoyance and something we desperately try to ignore. Sometimes they pierce our best defenses on the merits of their creativity, their wit, or their humor. However, sometimes they do so for the wrong reasons – as in the case of a recent commercial from State Farm®.

In this commercial, two twentysomething women are shopping for accessories in a trendy, expensive-looking boutique. They quickly discover a beautiful handbag – cue astonished look in the image to the right. One of the ladies sings the State Farm jingle and her insurance agent magically appears. She doesn't ask him to review her policies with her, walk through her coverage limits, or identify risks she may not have adequately covered. No, instead she curtly asks him how much she is saving with her "Discount Double Check." Evidently that figure is \$150, and upon hearing that dollar amount she pivots toward the cash register and rushes off to buy the shiny new red purse she already had in her hand.

Upon even cursory reflection, this sequence exposes a great deal about some of the cultural challenges our nation faces regarding the role of insurance and financial responsibility.

Let's consider this transaction for a moment. Perhaps she might have wondered how the insurance company managed to save her that \$150. Did they pare back her liability limits, exposing the rest of us to liability she now can't cover? Did they switch coverage for her personal property from replacement cost to actual cash value? (In the case of fire they would pay only the depreciated value of her belongings, not what it costs to repurchase them.) Did they reduce the coverage she had for uninsured motorists that would make sure she would be supported financially if she were injured by someone without insurance? Did they switch from a company that readily pays claims to one that gives their policy holders a hard time?

Purely for purposes of discussion, let's for one moment concede that the \$150 savings is legitimate. The young lady could use those funds to pay down that credit card bill a little. She could contribute a little more to her retirement plan at work. She could even start dollar cost averaging into a low-cost, balanced, globally diverse portfolio. But she did none

of these things. She ran to the cash register with that new purse in one hand and her credit card in her other before you could even say "401(k)."



In our nation of hyper-consumerism, it seems we value a new purse more than our financial security or our duty to protect those around us. The ad agency that created this State Farm commercial, Translation LLC, knows this reality – they are real pros. They count McDonald's, GM, Budweiser, Target, and dozens of other high-powered brands on their client list. In fact, their tagline is "We help ambitious brands thrive in contemporary culture."

With every commercial that is aired, the reality is driven home that each of us is up against veritable armies of the best and brightest minds in advertising and marketing who are persuasively convincing us that our hard-earned dollars are better spent on the products of their clients than deposited in the coffers of our retirement savings. It takes forethought, discipline, constitution, and a commitment to your long-term security to ignore the bombardment.

...it seems we value a new purse more than our financial security...

The role of your insurance company should not be to help you figure out how in the world you are going to afford yet another purse.

All the way back in 1983, author Paul Wachtel wrote in *The Poverty of Affluence*: "Having more and newer things each year has become not just something we want but something we need. The idea of more has become the center of our identity and our security, and we are caught up by it as the addict is by his drugs."

Let's be clear, we certainly aren't suggesting that women shouldn't buy purses—or even expensive ones. In the end, our message is that insurance is about asset protection; and secondarily, that an insurance company shouldn't be fueling the fires of consumerism. The concept of insurance in its most pure form is to protect against highly infrequent but potentially catastrophic events. Adequacy of coverage must predominate over ancillary factors such as shaving a few bucks off the annual premium.

Many Happy Returns

The holiday season encourages media retrospectives about financial markets. It's often revealing to match these year-end tallies with what pundits were saying at the beginning of 2012. We thought we would examine the 2012 predictions of the chief strategists at Morgan Stanley, Goldman Sachs, UBS, and Bank of America-Merrill Lynch. Keep in mind that these organizations have **essentially limitless resources to equip their teams of economists with every tool possible** for accurately predicting the year's equity returns. As you digest these forecasts, you'll want to consider that the S&P 500 index opened the year 2012 at a level of **1,259**.

We'll start with Adam Parker, strategist from Morgan Stanley known for his intelligence and analytical ability. He's one smart guy – he's earned a PhD in statistics from Boston University, an MS in biostatistics from the University of North Carolina, and a BS in statistics from the University of Michigan. For 2012, he had predicted a down year for the S&P 500, coming in around **1,167**.

Parker told us, "Our more cautious view on earnings stems from three key factors. 1) We see global GDP decelerating over the next few months in nearly every major geography. 2) Recent company results have been weak...This likely portends weak January results or April guidance. 3) The dollar has materially strengthened against the euro over the last few months and our analysis shows this is highly correlated to earnings downside, with select staples, technology, and materials likely impacted. Furthermore, inventory levels remain crucial, as several industries now have inventory-to-sales ratios well above five-year averages."

Then you have Goldman Sachs strategist David Kostin, who believed we were heading to **1,250** but only if Europe could keep its act together. However, if

Europe continues on its path, "the sovereign debt crisis worsens almost daily. S&P 500 could drop 25% to **900**."



UBS Chief Strategist Jonathan Golub saw the S&P 500 at **1,325**. Here's what he said was driving his forecast:

"While we project the market to rise in 2012, we would not be buyers at current levels and anticipate more attractive entry points in the future. 2012 should again be a struggle between stronger domestic fundamentals and macro risks. Despite recent gestures by central bank officials, we believe that equities will struggle in the face of European recession currently being forecast by UBS economists."

It turns out that the S&P never dropped below its opening day value for the year – there were no more attractive entry points.

Michael Hartnett, chief global equity strategist at Bank of America-Merrill Lynch, expected the S&P to close at **1,350**, or up 6.7% on the year. However, if Europe took a turn for the worse, Hartnett believed we could be looking at a **1,000** S&P, a 21% drop from the 2012 starting levels.

Bad or good economic news is important to stock prices only if it is different from the information that the market has already priced in.

Our point is that there was so much for forecasters to get right—the negotiation of the eurozone crisis, uncertainties over the growth of earnings, the roadblock of the U.S. presidential election, and the challenge for emerging economies to sustain high economic growth rates.

Twelve months after these predictions have been made, markets are still grappling with many of the same issues, though from different angles. Much of Europe is either in recession or growing only modestly, unemployment is high, and a number of countries that use the euro are unable to pay their debts. The U.S. presidential election gave way to worries over the “fiscal cliff,” while Chinese exports have been hit by the slowdown elsewhere. It was really **difficult to predict in advance that in 2012 the S&P 500 would close at 1,426**, an increase of 13.4%.

In the meantime, however, there have been solid gains in many equity markets, including parts of Europe and Asia as well as North America. The *Barron's* panel forecast of the S&P 500 reaching 1,360, which the magazine said was ambitious, now looks conservative. What's more, some of the strongest performances have been in emerging and frontier markets.

Developed Markets (USD)			Emerging Markets (USD)		
Country	YTD	3YR	Country	YTD	3YR
Belgium	36.80%	6.70%	Turkey	53.60%	12.80%
Denmark	28.10%	10.90%	Philippines	42.40%	24.80%
Singapore	27.10%	10.40%	Egypt	36.00%	-4.50%
Hong Kong	27.10%	10.30%	Pakistan	28.90%	13.30%
New Zealand	26.80%	14.70%	Poland	28.30%	0.30%
Germany	25.80%	4.20%	Thailand	26.80%	27.30%
Austria	19.00%	-7.80%	Hungary	26.70%	-9.10%
Switzerland	18.80%	8.00%	Colombia	26.10%	21.00%
Australia	18.60%	7.10%	India	26.00%	-0.30%
Netherlands	17.40%	2.90%	Mexico	24.00%	12.60%
France	17.10%	-1.50%	China	17.10%	0.10%
Sweden	17.00%	9.20%	Taiwan	15.60%	6.60%
Norway	16.80%	7.00%	Korea	15.30%	11.70%
United States	14.30%	10.70%	Peru	13.40%	8.50%
United Kingdom	12.90%	7.10%	Malaysia	9.80%	14.90%
Finland	9.70%	-6.00%	South Africa	7.90%	9.20%
Italy	8.60%	-10.50%	Russia	7.10%	1.90%
Canada	7.40%	5.20%	Chile	3.30%	8.80%
Japan	2.70%	0.80%	Indonesia	2.90%	15.60%
Greece	2.00%	-42.50%	Jordan	-1.70%	-9.00%

The table above shows performances for 2012 (through November 30) and annualized returns for the past three years for twenty developed and twenty emerging markets, using MSCI country indices.

Among developed markets, three members of the seventeen-nation eurozone—Belgium, Germany, and Austria—were among the top ten best-performing

equity markets this year. Leading the way among emerging markets was Turkey, which regained its investment-grade ranking from agency Fitch in November.

While not one of the top performers, the U.S. market still delivered positive returns in what many observers judged as a highly uncertain economic and political climate.

And while much of the media focus has been on the so-called BRIC emerging economies of Brazil, Russia, India, and China, the real stars in the emerging market space the past three years have been the Southeast Asian markets of the Philippines, Thailand, and Indonesia.

There are a few important reinforcements here to lessons you already know. First, while the ongoing news headlines can be worrying for many people, it's important to remember that markets are forward-looking and absorb information very quickly. By the time you read about it in the newspaper, the markets have usually gone on to worrying about something else.

Second, the economy and the market are different entities. Bad or good economic news is important to stock prices only if it is different from the information that the market has already priced in.

Third, those who are tempted to invest via forecasts need to realize that it is not just about predicting what will happen around the globe, but it is also about predicting correctly how markets will react to those events. That's a tough challenge that no one has been able to reliably and consistently meet.

Fourth, you can see there is variation in the market performance of different countries. That's not surprising given the differences in each market in sectoral composition, economic influences, and market dynamics. That variation provides the rationale for the diversification we've built into your portfolio—spreading your risk to smooth the performance of your portfolio.

So it's fine to take an interest in what is happening in the world. But care needs to be taken in extrapolating the headlines into your investment choices. It's far better to let the market do the worrying for you and diversify around risks you are compensated to take.



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