Wealth Management

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Despite Media Fury, Few Pros Predict Recession

For months now, investors have been bombarded with so many reports of a recession ahead that the markets have seemed more than a little shell-shocked. But while the media have fixated on the gloomiest forecasts, most economists actually predict moderate economic expansion.

The Economic Cycle Research Institute (ECRI), made waves on September 30, 2011, when it announced that, according to its data, an economic downturn was nigh. "The most reliable forward-looking indicators are now collectively behaving as they did on the cusp of full-blown recessions, not 'soft landings,'" ECRI said. "The U.S. economy is indeed tipping into a new recession. And there's nothing that policy makers can do to head it off."

Three months later, ECRI stands by its prediction, and sooner or later it may come true. But in the meantime, investors may want to note three key points that say as much about how economic hype propagates in today's hyper-connected environment as they do about the underlying economy itself.

1. "Secret" methodologies are hard to trust.

ECRI economists made their reputation by calling the bottom of the 2007-2009 recession in March 2009—and again in 2010 for saying no "double-dip" recession was imminent. But they have been vague about exactly which "forward-looking indicators" are making them so nervous. Their methodology is proprietary, a secret to all except the firm's clients.

At the same time, the indicators the rest of the world has to work with give no clear signal of a recession ahead. Denver economist Fritz Meyer, a 35-year veteran of the industry, notes that according to the more established index of Leading Economic Indicators—published by the Conference Board for the past half-century—the economic environment seems to be improving. "The risk of economic downturn has receded, and the forward-looking economic data has actually picked up a little bit," Meyer says.

Meyer and other independent economists can check the Conference Board's work and judge the results for themselves, but ECRI's calculations remain a "black box" opaque to third-party verification.

2. Other economists see no recession on the horizon.

In contrast to whatever ECRI has seen, economic numbers from the Conference Board remain fairly strong. New factory orders from the Institute for Supply Management have actually improved during the past few months, for example, and vehicle sales, commercial lending, and non-manufacturing economic activity all picked up during the past quarter.

In fact, no significant economic gauges have turned downward. "Economists continue to believe that the U.S. economic expansion will continue at a relatively robust rate," Meyer says, citing a December Wall Street Journal survey revealing that, on

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Kane Co. Launches Document-Sharing Client Portal

Kane Company P.C.'s new client portal is a password-protected space where we can exchange business files easily and securely. It is designed to be a convenient tool for our clients to upload documents to their individualized client account for us (such as income tax source documents and 401(k) statements), and allows us to quickly and safely provide our clients with documents such as quarterly investment statements and completed tax returns. It utilizes the same data encryption technology as e-commerce and online banking, and is certified under the U.S. Department of Commerce's Safe Harbor program.

If you have not accessed your client portal account yet, please take a few minutes to check it out. It can be accessed right from our website homepage at http://www.kanecompanypc.com or directly at https://kanecompanypc.sharefile.com. Simply click on "client login" and input your username and password. If you do not recall receiving your login information from us, please contact our office and we would be happy to resend it to you.

2011 Tax Reminder: It is not too late for us to prepare your tax return. Please contact our office to schedule a meeting or upload your source documents to your client portal account so we can prepare your return or file an extension by April 17.

Steven L. Kane, CPA/PFS, CFP®

Labor Market Showing Multiple Signs Of Life

After years of frustration and outright skepticism, investors and job seekers alike are finally acknowledging that the most closely watched piece of economic data in the world—the monthly payroll survey from the U.S. Department of Labor—is pointed in the right direction.

December's statistics revealed that U.S. employers created a net 200,000 jobs, enough to keep up with population growth and even put a few of the long-term unemployed back to work. The number was especially welcome, coming as it did mere months after the summer's federal budget debate effectively froze government hiring.

As independent economist Fritz Meyer notes, the government has gone from being a major creator of jobs to becoming a drag on the overall labor market. He thinks that's actually a good thing as the private sector picks up the slack. "I think in many cases, government budgets need to be squeezed," he explains. "Nonetheless, we're seeing continued year-over-year government job losses. Until that turns around, the headline number [for overall monthly job gains] probably won't go back to 400,000 or 500,000 as it has during previous recoveries."

Meyer points to the survey of private-sector employment released each month by payroll processing company ADP as the really good news. According to ADP, a net 325,000 Americans found jobs in December—many more than the Labor Department statistics, which include government hiring and firing, would indicate.

For many economists, the question now is whether U.S. businesses will keep creating jobs as overseas economic conditions stagnate and the government pulls back further. Meyer is still watching weekly unemployment claims numbers, down substantially in recent months. And the fact that planned layoffs dipped to a six-month low in December is also a positive sign for those worried that the summer's financial market gyrations would drive employers to put expansion plans on hold.

While the number of layoffs in December came in 31% above 2010 levels, that reflected a record number of government job cuts. Taking the public sector out of the equation, 20% fewer Americans lost jobs than were laid off the previous year.

Granted, the job market still has a long way to go to recover all the ground lost between early 2008 and early 2010, when a net 8.7 million jobs were destroyed. But as corporate employers take the baton from the government and put people back to work, economists feel confident the recent surge in hiring will eventually translate into improved consumer sentiment and, ultimately, more robust household balance sheets.

If anything, the extent of the damage may only make the eventual recovery more sweet. As Fritz Meyer says, net new job formation now actually looks a lot stronger than we saw during the first two years following the previous recession. ●

Be Wary Of Market Pundits' Track Records

Turn on the television and you'll see self-appointed experts from big Wall Street firms weighing in on how various securities, sectors, and asset classes will perform. Some forecasts are closely argued and even compelling, while others boil down to off-the-cuff responses to the question, "what do you like?"

Either way, nobody ever seems to track all the recommendations to find out who, if anyone, actually has a working crystal ball—and whether pundits' forecasts deserve to be taken seriously.

But independent economist Fritz Meyer has been watching, following up on predictions from some of the biggest Wall Street firms: Morgan Stanley, Goldman Sachs, JPMorgan, and others. And he has discovered that, sector for sector, these highly compensated, widely quoted market gurus have failed to beat the market in any meaningful way.

At the end of 2010, eight out of 10 market strategists told Barron's they expected technology stocks to outperform during the new year. Six picked industrials and six picked energy. Those sectors ended 2011 up 1%, down 3%, and up 3%, respectively.

Not great, when you consider that the "experts" steered clients away from the sectors that delivered the bulk of the broad market's performance that year: utilities, consumer staples, and healthcare. "They were pounding the table last year on technology," Meyer says. "That was a mistake. In fact, they didn't make any good sector calls that I've been able to identify."

Go back a year, and the results weren't quite so dismal, Meyer says, although pundits' predictions for 2010 didn't turn out to be particularly prescient. Technology was also the top choice back then—but while tech stocks might have looked attractive at the beginning of the year, they ended up underperforming the broad market by 3

Study Shows Impact Of Great Recession

It was dubbed the Great Recession, and by any measure, the economic downturn that officially ended in June 2009 has been financially wrenching for almost everyone. Millions of jobs were lost, wages remain stagnant for those who were able to keep working, and poverty rates have soared. More than two years after the economy bottomed out, unemployment continues to hover at around 9% and growth in the U.S. gross domestic product still hasn't hit its post-recession stride.

The impact of the Great Recession will resonate for years to come, especially as it relates to retirement savings. Many people were forced to tap retirement plan accounts to weather the economic storm, and those who weren't working lost ground in accruing Social Security benefits. Supported by a grant from the Social Security Administration, the Center for Retirement Research at Boston College released an executive paper in May 2011 summarizing the impact of the Great Recession on future retirement income. It projects average incomes for adults who were between the ages of 25 to 64 in 2008 and compares the results to what people might have received had the recession not occurred. Consider these key findings.

1. The Great Recession will reduce future retirement income across the board, but it hits hardest at young workers and high-income earners. Adults between age 25 and 34 in 2008 can expect to see their income at age 70 be 4.9% lower (an average of $3,000 per person) as a result of the economic slowdown. Younger workers were more likely to lose their jobs than were older employees during the recession, and the impact of their missing retirement savings is magnified by the decades the money would have had to compound.

2. Older workers, however, are not immune to the impact of the recession. The income at age 70 for those who were 55 to 64 in 2008 is expected to decline by 4.1%, mainly because they'll receive less in Social Security benefits. Job losses and wage stagnation during the recession negatively affects the Social Security benefit formula for those who turn 60 after 2008. Also, those who were near retirement age during the recession and were laid off are statistically unlikely to rejoin the work force. Relatively few adults return to work if they become unemployed in their early 60s.

3. In absolute terms, those with the highest incomes will experience the greatest decline in retirement income. For example, younger workers in the top income quintile can expect to lose $7,500 per person annually, while those in the bottom quintile are projected to lose only $400 a year. Reduced earnings will further limit future income from pensions, retirement accounts, and other assets. Statistically, workers in lower-income groups won't fare as poorly, but only because they are less likely to have retirement plans and tend not to be able to save much, even during the best of times. Relatively speaking, however, high-income groups won't lose much more than lower-income groups because the large absolute losses of the high earners account for a smaller share of their overall income.

4. The decline in household income caused by the Great Recession will increase the number of people living on limited incomes at age 70. For those who were between the ages of 25 and 64 in 2008, the share of incomes below 125% of the federal poverty level at age 70 will increase by 7.4%, putting an extra 711,000 adults in or near poverty.

The Boston College researchers acknowledge that creating income projections for the next 40 years is an inexact science, and future events could significantly alter the outcomes their report predicts. For instance, an unusually long stretch of continued unemployment could have a negative impact on workers and result in even worse scenarios. Alternatively, average wages could rebound to levels that prevailed before the Great Recession, thereby offsetting more of the recession-related losses. The downturn might also encourage workers to change spending habits and focus more on retirement savings. Of course, such changes are less likely for older unemployed workers already near retirement.

Though statistical averages are interesting, your situation is unique, and even if you lost ground during the Great Recession, it's not too late to resume saving and planning for a rewarding retirement. We can help you assess your situation and make the adjustments you need to get back on track. ●

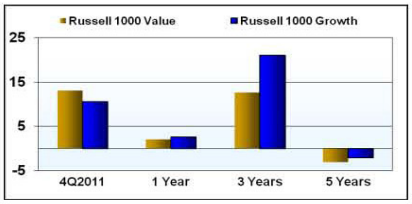
percentage points.

A majority of Wall Street heavyweights picked the industrial sector as a probable outperformer, which was a good call, Meyer says. But only one in three predicted the year's biggest winner—the consumer discretionary sector, which surged 26% in 2010—and just as many thought that healthcare, which turned out to be the worst-performing sector, would beat the overall market.

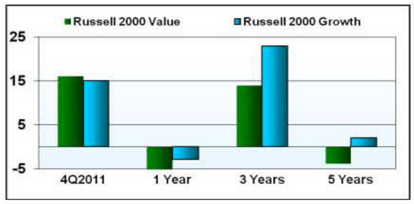
On average, simple portfolios constructed out of Wall Street's "expert" allocations came in within 1 percentage point of the broad market between the start of 2010 and the end of 2011.

This year, the gurus are picking technology and healthcare again. Should investors overweight those sectors? Fritz Meyer doesn't know, but their recent batting averages don't inspire much confidence. "The question in my mind has always been why you should listen to these guys," he says. Given that their choices seldom beat the market, Meyer suggests investors "stick with modern portfolio theory, broad diversification, and periodic rebalancing." ●

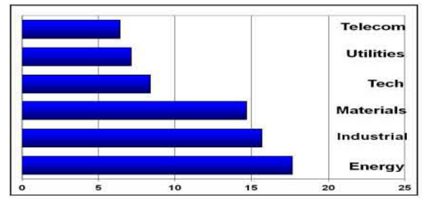
Market Data Bank: 4th Quarter 2011



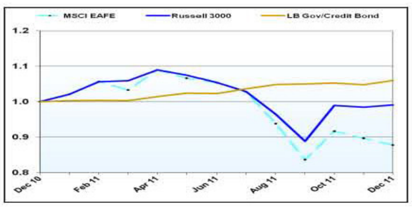
LARGE VALUE VS. LARGE GROWTH
U.S. conglomerates regained much of their recent losses in 4Q2011. Large value fared better than growth, up 13.11% between October and December, but growth's 10.61% rally was still impressive.



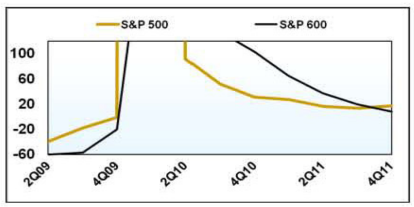
SMALL VALUE VS. SMALL GROWTH
Smaller stocks, seen as better exposed to a more robust economy, performed better than their larger counterparts. Small value surged 15.97%. Small growth kept pace with a 14.99% total return in the quarter.



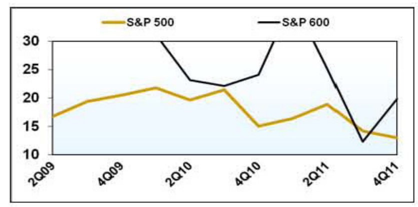
THREE BEST AND WORST SECTORS
After the near-universal losses of the third quarter, all ten sectors that Standard & Poor's tracks ended 4Q2011 in positive territory. Defensive telecom and utility stocks lagged; cyclical shares soared.



FOREIGN, US STOCKS & US BONDS
The euro saga eroded the value of foreign shares in dollar terms despite an October rally. Year-over-year, U.S. stocks ended 4Q11 flat, but Treasury debt remained in favor with risk-wary global investors.



LARGE VS. SMALL STOCK EARNINGS
Developments overseas sapped the ability of U.S. multinational corporations to grow in 4Q2011. Still, a brighter domestic tone translated into strong growth for smaller, more U.S.-focused firms.



PRICE-TO-EARNINGS RATIO
Given continued growth, large-cap shares were cheaper per dollar of operating profit in December than they had been in some time. Small-cap shares were also inexpensive by recent standards.

Small-cap stocks represented by Russell 2000 index, large-cap stocks represented by Russell 1000 index. Foreign stocks represented by the Morgan Stanley Capita/ International's Europe, Australia, Far East Index, and US bonds by the Lehman Bros. Government/Corporate Bond Index. P/E ratios exclude negative earnings. Small-cap stocks tend to be more volatile than large-caps. Bonds offer a fixed rate of return while stocks will fluctuate. Indices are unmanaged and do nott represent any specific investment. Foreign investing involves special risks, including political unrest, economic instability, and currency fluctuation. Past performance does not indicate future results.

Source: Russell/Mellon

Few Predict Recession

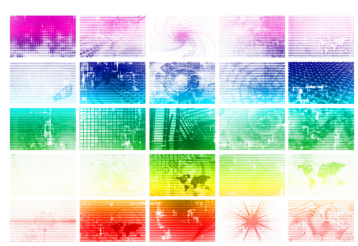
(Continued from page 1)

average, industry professionals suspected gross domestic product (GDP) growth would rise to nearly 3% in the fourth quarter.

That doesn't mean ECRI's secret recession recipe won't eventually be borne out. But in the meantime, publicly available numbers reflect the opposite of what is normally considered a recessionary environment.

3. Timing is everything. Timing the market is not.

Three months after ECRI's September recession prediction, it still weighed on investor sentiment, perhaps because ECRI had declined to provide a timeline for determining whether its call was right or wrong. In September, the group said the United States was on the "cusp" of a full-blown downturn, which would indicate some urgency. By mid-December, however, ECRI's time frame had softened to "sometime next year."



Recessions, like expansions, come and go, and there will inevitably be additional downturns, so ECRI was right on that front. But by moving the scope of its call further and further out, the forecasters have kept investors on edge, leading many to withdraw from investment markets to wait for brighter days ahead.

The problem, though, is that investing isn't something people do only when outside conditions make it convenient. It continues throughout the ups and downs of the economic cycle. And since September, the U.S. economy has shown every indication of continuing to expand, and financial markets, though volatile, have reflected that expansion.

The Standard & Poor's 500, a broad gauge of U.S. stock prices, climbed 8% between the time of ECRI's initial forecast and mid-December. An investor who fled to the sidelines to avoid that "full-blown recession" would have lost out on that appreciation, the equivalent of nearly a year of normal performance for large-cap shares. ●

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