The Thoughtful Investor™

James W. Olsen, CFP® | Legacy Investment Strategies | Second Quarter 2013

Unmanaged Index Funds Are Not Low-Risk Investments

How often have you encountered the following advice? *You can't predict the direction of the market so the safest investment is an index fund.* To an investment manager, that advice sets one's teeth on edge.

There's nothing safe about an index fund. An index fund is a creature of market direction. Whatever the index does, the fund is designed to mirror. Index funds offer no risk management, no ability to invest in top performers, and no guarantee of success. Investing in an unmanaged index fund is a gesture of faith that the economy and the industry segment represented by the index will grow during your investment time frame, and that the index will be positive when you need your money. It doesn't always happen that way.

Historically, index funds work best the longer your investment time frame, with lots of time to recover from down markets. If you happen to be retiring and you need to liquidate portions of an index fund, it matters a great deal whether the index is in an up or down trend. Withdraw in a falling market and you can quickly run out of money. The chart on page 2 shows the effect of withdrawing $10,000 a month from $2,500,000 invested in the S&P 500, Nasdaq Composite, 10-Year Treasury Bond index and cash over the last 12 years. The best investment? Cash.

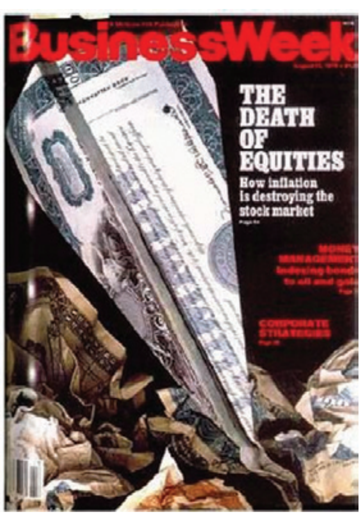
According to traditional investment advice, you lower the risk of investing by holding multiple low-correlation

continued on page 2

Contrarian Indicators Can Signal Market Turning Points

Where will the market be next month, or six months from now? Market analysts seek that answer in indicators based on everything from technical analysis to economic factors and human behavior. Squarely in the human behavior camp are contrarian indicators.

In 1979, *BusinessWeek* magazine's cover



proclaimed "The Death of Equities" and is still today hailed as one of the best examples of the contrarian *magazine cover indicator*. Rather than the death of equities, the issue was followed by one of the greatest bull market runs in history.

Contrarian Indicators are used to indicate turning points in the

continued on page 3

What To Do About Longevity

Ironically, one of the biggest threats to our long-term security is longevity. We are living longer, healthier lives. Even health care costs, the bogeyman in every budget, tend to be their highest at the very end of our lives. The catch, of course, is that the longer one lives in retirement, the more financial assets it requires to enjoy those years.

Financing longevity has a number of paths:

(1) Save more money now. Saving and investing is your best path to assuring the money is there when you need it. Being rich definitely helps pay the bills.

(2) Keep working. This has the benefit of allowing you to put off withdrawals from investments. Plus you can postpone receiving Social Security, increasing your eventual payments.

(3) Consider longevity insurance. This is an interesting insurance product that only pays out if you reach a designated age…such as 85. It's a bet that you will live long enough to collect more than the cost of the insurance.

(4) Long-term care insurance is also a consideration, but this only kicks in once you become incapacitated and no longer able to care for yourself. It's not exactly "enjoy your life" money, but rather "keep from bankrupting the family" money.

(5) Work with your financial adviser to position your investments to meet your financial needs, whether growth, capital preservation or income.

Unmanaged Index Funds Are Not Low-Risk Investments — *continued from page 1*

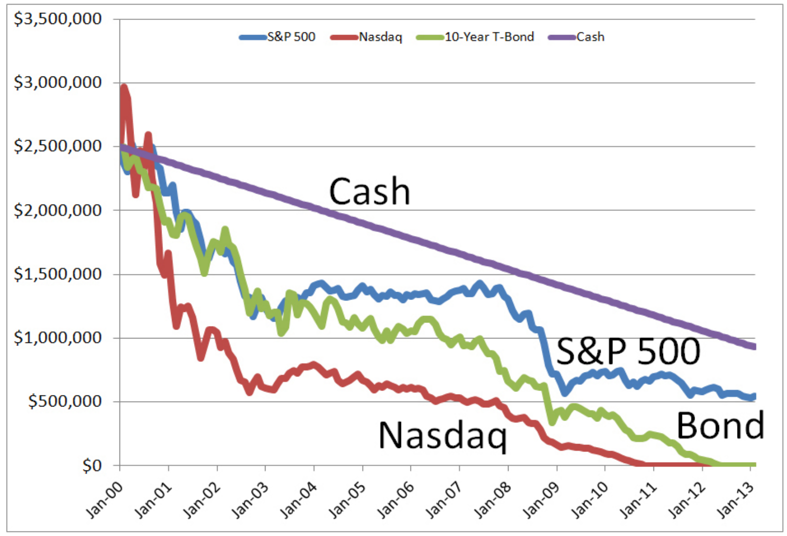
index funds covering different asset classes. The concept behind holding uncorrelated assets is that they should not all move in the same direction. When one goes down, hopefully another will increase. But this also fell apart in the time frame shown at right.

The popular market segments used in traditional portfolio diversification based on fundamentals and capitalization (large-cap value, large-cap growth, mid-cap value, mid-cap growth, small-cap value, small-cap growth) tend to become highly correlated in market downturns. In the 2008 bear market, indexes based on these segments moved lock-step downward.

Incorporating risk management in a portfolio requires active management. A mixed approach of reducing equity allocations in periods of falling prices and increasing cash positions; and the reverse in rising markets, has the potential to provide investors with the best of both worlds – the preservation of capital offered by cash and the opportunity for appreciation from an equity investment.

With that said, success in active management depends on the ability of the manager to accurately determine the direction of the trend and position assets accordingly. There can be no assurance that an active strategy will be implemented successfully.

Impact of Withdrawing $10,000 a Month from Index Funds or Cash 2000-2012



Data: Yahoo Finance. Past performance is not an indication of future returns. In a different time series, results would differ. The S&P 500, Nasdaq and 10-year Treasury Bond are unmanaged indexes and cannot be invested in directly. The chart above does not reflect transaction costs, which would have the impact of further lowering balances.

Identity Theft is Alive and Thriving

I was going through some old brokerage account statements from 20 years ago and was surprised to notice each statement included not only my name, address and account number, but also my Social Security number. While Social Security numbers disappeared from statements years ago, there are plenty of records like this that provide a wealth of information for identity thieves. And individuals are not the only ones being targeted. Investment advisers are encountering emails that appear to be from a client, sent from the individual's email, explaining that he is traveling and needs the adviser to wire funds to an overseas account. Account number, social security number and address are included to validate the request.

Minimizing the chance that you will be a victim of identity theft requires care that you do not unknowingly provide information to the thief, through careless handling of documents or responding to what you think is a legitimate request.

Some common techniques to gather information for identity theft include emails with fraudulent web links, attachments or phone numbers. Common topics are:

- An automatic payment has been made from your account.
- Confirming that a delivery has been made to your home or office.
- Reporting an unusual transaction on your credit card.
- Notifying you that an account has been blocked due to suspicious activity.
- Reporting that an automatic deposit has failed.

Or you may get a phone call notifying you that a transaction has failed, a credit card charge been declined or been made to your card, etc., requesting information to verify that you are the account owner.

Identity thefts like this work because they are designed to mimic communications that might ordinarily occur. Your best defense is always to NOT respond to links and numbers provided in emails or phone calls, but to contact the firm directly, whether our company or your credit card company, bank, delivery firm, etc. Never use links in emails to access account information, but rather go directly to the appropriate website to log in.

If at any time you receive an email or communication from our firm that appears suspicious, please contact the office directly. While we are committed to doing our best to protect clients, we can't control information beyond our office. That is where we ask that you be vigilant.

Contrarian Indicators Can Signal Market Turning Points — *continued from page 1*

financial markets. A contrarian indicator is a data point, sign or event whose actual significance with respect to the market is the exact opposite of what your first impression might be.

According to the magazine cover indicator, the cover story on the major business magazines often indicates the precise opposite will happen. The theory is that by the time the media gets a hold of a trend, the crowd consensus has become too lopsided and that side of the trade is exhausted.

Contrarian indicators are warning flags. By recognizing these indicators, the investor's goal is to avoid being in the wrong investments when the market changes direction. Naturally, there's a catch. "The market can stay irrational longer than you can stay solvent," maintained economist John Maynard Keynes (1883-1946), and the years since his death have not proved him wrong.

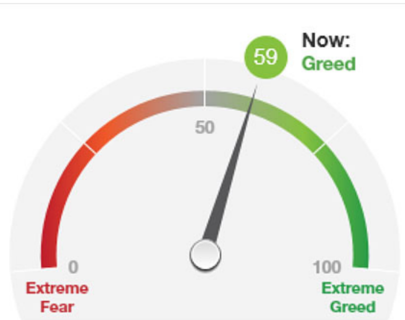
With that said, however, keeping an eye on some of the major contrarian indicators can provide investors with an "alert" as to the potential of a turning point in the market's direction.

At the center of all contrarian indicators is investor sentiment. Contrarian indicators rely on the principle that at market extremes, investors begin reacting emotionally, becoming too enthusiastic or too pessimistic. These moments of excessive greed or fear occur prior to, or coincident with, major turning points. In these times of "certainty," investors tend to follow herd-like behavior. When everyone shares the same belief, there's no one to take the other side of the trade and move markets higher or lower, often resulting in a sustained reversal in market direction.

Commonly Followed Contrarian Indicators

Sentiment surveys ask if investors are Bullish, Bearish or Neutral. Contrarian investors look for extremes in investor sentiment surveys, such as the AAII retail sentiment indicator. When sentiment is at an extreme Bullish or Bearish level, the indication is that the reverse is in store for the market.

Fear & Greed Index
What emotion is driving the market now?

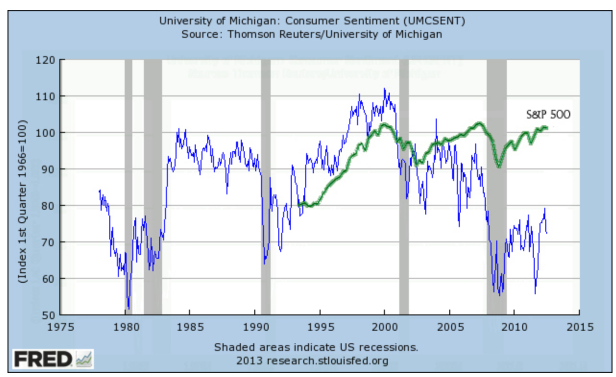


CNN's Fear & Greed indicator can be found at http://money.cnn.com/data/fear-and-greed/

Consumer confidence at a multi-year low often leads to market rallies. Extreme optimism is typically associated with a market high, while extreme pessimism tends to lead a recovery.

One measure of consumer confidence is provided by The Conference Board Consumer Research Center, based on a monthly survey of a representative sample of 5,000 U.S. households. In January 2013, the Center's Consumer Confidence Index stood at 58.6 (1985=100), down from 66.7 in December, essentially erasing all the gains in consumer confidence made during 2012.

Consumer Sentiment Compared to the S&P 500



The University of Michigan's Consumer Sentiment index, found on the Federal Reserve St. Louis web site – http://research.stlouisfed.org/fred2/series/UMCSENT, is overlaid with a plot of the S&P 500.

Investment outflows much like consumer confidence, usually hit their highs before market bottoms. Inflows reach excessive levels just before markets peak.

The **health of the financial media** reflects investor confidence in the financial market, with high closing rates as the market nears a bottom and new media launches at market tops when Main Street investor interest is the greatest. The number of advertising pages in a magazine is another indicator of health.

Non-commercial traders surpass commercial traders as shorts at market lows. When the crowd discovers an investment strategy, it's often a clue that the strategy may have run its course.

A number of data indicators are used to look for contrarian signals in **extreme market behavior** such as the Put/Call indicator, developed by Marty Zweig in the early 1970s, that looks for spikes when investors are scared and buy puts, or are overconfident and call buys dramatically increase.

The VIX volatility index, percentage of New York Stock Exchange stocks above their 40-day moving averages, advance/decline statistics, and new highs versus new lows are other contrarian indicators.

There are also contrarian strategies that look for individual stocks that are publicly disliked but fundamentally sound, or strive to short or avoid stocks that are popular with investors, but over-valued in terms of fundamentals.

The most important thing to remember about the indicators is that they are best confirmed through hindsight. Contrarian indicators are typically subject to interpretation; they're not infallible and they can be very difficult to pin down with respect to the timing of the high or low they may anticipate. But investors ignore them at their own risk.

RETURN SERVICE REQUESTED

James W. Olsen, CFP®
Legacy Investment Strategies
1601 Belle Chasse Hwy. Ste. 200
Gretna, LA 70056
PH: (504) 361-7788
Fax: (504) 361-8844
Toll Free: 800-592-4011
www.legacyinvestment.net

401(k)'s Eligible for 2013 Roth Conversions

Historically, higher income individuals have been shut out of contributing to Roth retirement accounts based on income limits. But in 2010, income restrictions on **converting** a traditional IRA to a Roth IRA were lifted. Now with the American Taxpayer Relief Act of 2012, 401(k) plan participants can convert funds held in their traditional 401(k)s into Roth 401(k)s regardless of income. To convert, you have to pay income taxes on any account balance that has not already been taxed. Since this balance is typically taxed at your highest tax rate, that can put a sizable current cost to converting.

The advantage of a Roth IRA and Roth 401(k) is that gains can be withdrawn federal-income-tax free in retirement. Converting now may also allow you to pay lower taxes on the conversion amount than you might in retirement. If you anticipate higher tax rates will impact your earnings in retirement, this can be a sizeable benefit. Some other advantages of a Roth account include:

- Rollover contributions to a Roth IRA may be withdrawn tax and penalty free after the "seasoning" period (currently 5 years). Earnings may be withdrawn tax and penalty free after the seasoning period and once the account holder reaches age 59½ (or other qualifying conditions are met).
- Distributions from a Roth account do NOT increase your Adjusted Gross Income and may help avoid the "unearned income" tax contained in Affordable Health Care for America Act. Withdrawals also don't count toward Social Security tax.
- Up to a lifetime maximum $10,000 in earnings withdrawals are considered qualified (tax-free) if the money is used to acquire a first-time principal residence for the Roth owner, spouse, or qualified relative.

Should you convert? That depends on your answer to the following questions:

1) Do you have the ability to pay income taxes on previously untaxed contributions?
2) Will the conversion push you into the higher income tax bracket for top earners offsetting the potential advantage of tax-free withdrawals of gains later in life?
3) How long do you have until retirement? Conversions could be most beneficial for younger savers whose converted funds will have more time to grow tax-free within a Roth. These individuals may also be in a lower tax bracket today than they expect to reach later in life.

Keep in mind this is a very brief overview. Your employer may not offer a 401(k) Roth option. Regardless, talk with your financial adviser to make certain you understand the pros and cons before converting a traditional 401(k) into a Roth 401(k).

Did You Convert a Traditional IRA to a Roth IRA in 2010?

The ability to convert a traditional IRA to a Roth IRA in 2010 also came with the ability to split tax payments on the converted balance over your 2011 and 2012 tax years. If you converted using the split tax basis, don't forget to make the 2012 tax payment when you file this year.

Charitable Contributions from IRAs Continue in 2013

Another impact of the recent tax law was the extension through 2013 of the ability of taxpayers 70½ and older to donate up to $100,000 of individual retirement account assets directly to a charity and count the contribution as part of the individual's required distribution. While the individual cannot deduct the gift, neither does it count as income. This can help reduce gross adjusted income and minimize Medicare premiums or taxes on Social Security benefits.