

INVESTMENT UPDATE

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The sharp downturn in stocks last year and quick rally this year confused investors. 2

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Points of interest:

- Harvard's endowment lost \$11 billion and Yale's dropped by \$7 billion.
- The endowments had beaten the markets for years by using unconventional investments.
- Their hedge fund and private equity assets became illiquid in the 2008 financial crisis.
- The endowments didn't hold enough safe assets to weather the storm.

YALE AND HARVARD STRIKE OUT IN A YEAR OF INVESTMENT TURMOIL

You might go to Harvard or Yale to get a top-notch education in medicine, literature, or physics, but don't expect to sharpen your investment skills by following their lead.

The Harvard and Yale endowment funds — touted for years as being on the cutting edge of new investment practice — sustained massive losses last year after a decade of beating the stock market.

It turns out that their highly-touted "alternative" investments—which were supposed to shelter them from big declines in the stock market—instead turned out to be major money losers.

And, to add insult to injury, their mainly illiquid investments forced the endowments to hang on while prices plunged further.

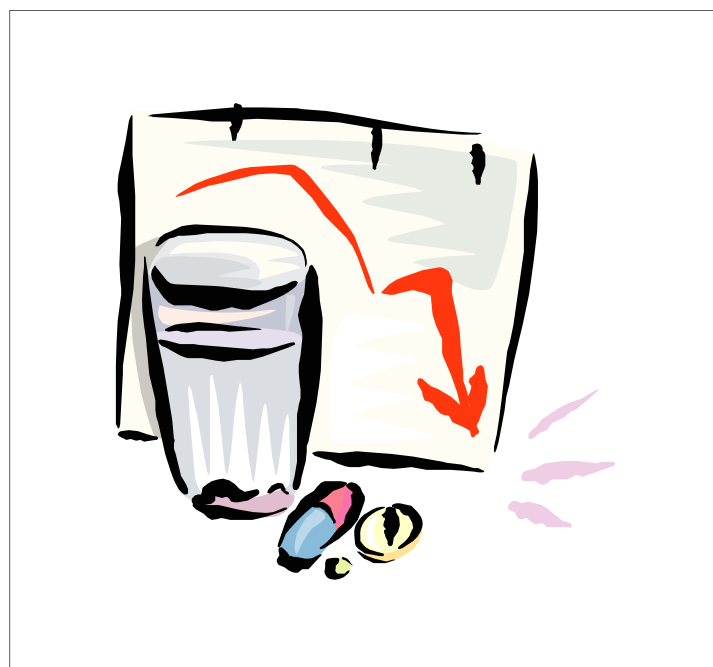
The 27 percent, \$11 billion loss at Harvard, and the 30 percent, \$7 billion loss at Yale, have caused layoffs and budget cuts at both schools.

They also offer a textbook warning to investors on how *not* to invest.

Asset diversification

Yale endowment fund's David F. Swensen and his counterparts at Harvard have long preached the virtues of holding a diversified portfolio of investment assets whose movements are not fully correlated.

So far so good: much



The bear market gave unaccustomed headaches to the managers of the Harvard and Yale university endowment funds.

investment research supports investors who hold a mix of bonds, different types of stocks, real estate investment trusts, and commodity-backed instruments.

Smart investors can — and do — construct diversified portfolios using those asset classes, often through mutual funds or electronically-traded funds listed on major stock exchanges.

Although such investments are subject to the vagaries of the market, they can be sold or redeemed at any time without restriction. Holding a portion of a portfolio in short-term Treasury, municipi-

pal, or corporate bonds, as well as some cash in a money fund, also provides an investor with "safe" money that can be accessed without loss even when the stock market is plunging.

Illiquid assets

But Harvard and Yale took it a step further: they wanted to super-charge their returns by using non-traditional investment vehicles, such as hedge funds, private equity investments, even direct ownership of real estate and commodities such as stands of timber.

They argued they could

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A LACK OF LOW-RISK HOLDINGS HURT ENDOWMENTS IN BEAR MARKET

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be patient investors because they were investing for 100 years, not 25 like the typical long-term individual investor.

Unfortunately, they found that those non-traditional investments got caught up in last year's turmoil and slammed their doors shut to those running for the exits.

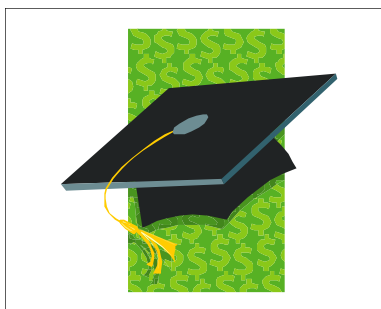
The endowments were locked into these illiquid vehicles at the same time that their publicly-traded stock holdings were dropping. Be-

cause they had such low portions of their portfolios in liquid cash or short term bonds—just 4 percent in Yale's case—they had nowhere to draw cash to satisfy their obligations to the universities.

Borrowed money

Harvard compounded the problem by borrowing money to invest—it had a negative cash position of 5 percent.

Even worse, some of the private equity investment contracts required the endowments to keep adding money



University money managers flunked.

as the private equity funds plunged, forcing them to sell off stocks that were falling in order to meet those obligations.

REGRETS MAY PARALYZE SOME INVESTORS

It is bad enough that investors lost a lot of money in 2008 during a frightening world financial crisis.

The sudden and swift recovery that began in March may be even worse for panicked investors who had barely a day to catch their breath between swings in the market.

Now many investors who suffered through the bear and still regret their inability to have sold out before the decline are sitting on the sidelines wondering whether it is safe to commit new money to stocks.

In the meantime U.S. stocks, which fell by a stunning 57 percent from their highs in 2007 (as measured by the Standard & Poor's 500 Index), have rallied by 50 percent since March 9.

Idle cash

The sudden shift in sentiment has left a lot of investor money out of the stock market: nearly \$3.5 trillion sat in money market mutual funds at the end of September.

Some media financial "experts" are saying the recent rally is merely a head fake and that the bear market will reassert itself in the coming months.

Investors regret both their losses from last year and having missed some or all of the 2009 rally.

The best cures for these regrets and uncertainties are a long-term view, an acknowledgment that forecasting is very imperfect, and a balanced investment approach.

Market history going back 200 years is clear: large downturns like the 2008 bear have inevitably been followed by extended recoveries. But the history also shows that those recoveries are uneven:

there can be declines of weeks, months, even a year or more, within those upturns, obscuring the breadth of the upturn as it is happening and only allowing it to be seen in retrospect.

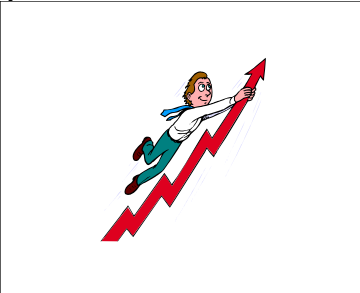
Forget forecasting

Anyone who believes that accurate forecasting is possible should look at their own track

record. Did they get out of stocks at the high of October 2007? Did they buy in at the low in early March?

The most important realization is that investing should not be an all or nothing game. At all times a rational investor

should have a balanced portfolio with some cash, bond, and stock holdings. A balanced allocation will reduce the regret over suffering losses and missing gains, and give an investor confidence to keep investing new money regularly.



The sudden and sharp stock rally that began in March surprised many investors who were still reeling over losses from the 2008 bear market.

"Investors regret both their losses from last year and having missed some or all of the 2009 rally."

STOCK MARKET NEWSLETTERS DIDN'T SEE BEAR COMING EITHER

"We've long felt that the only value of stock forecasters is to make fortune tellers look good," billionaire investor Warren Buffet has written.

That pretty much described how newsletters devoted to giving readers tips on the market fared in the fall of 2008.

The Hulbert Financial Digest, a newsletter that tracks the performance of the investment newsletter industry, looked back at what newsletters were saying in September 2008 and found that they did a poor job of alerting readers to the disaster that occurred in October.

Editor Mark Hulbert said many of the major newsletters seemed "strangely complacent" on the eve of one of the worst-ever months for stocks.

Bullish forecasters

He notes that Jeffrey Hirsch, editor of *Almanac Investor*, said he was "ready to be a bull again."

Bob Brinker of *Brinker's Marketimer* predicted the

Standard & Poor's 500 Index would top its previous record of 1565 in 2009 (it is now at about 1060).

Mark Skousen of *Forecasts and Strategies* predicted a "Santa Claus rally" at the end of the year, while Stephen Leeb of *The Complete Investor* said that the credit crisis had neared a conclusion and the downside risk in stock prices had been reduced.

Best of the bunch

A handful of writers seemed to get it right, but their forecasts were deceiving, Hulbert said.

The Elliott Wave Financial Forecast said the market was building toward its "strongest decline of the bear market to date."

The only problem with that forecast was that the newsletter had been overwhelmingly bearish for 20 years, and investors who followed its recommendations



Fortune tellers might make better forecasts than investment newsletters.

would have missed out on the big gains of the 1990s and mid 2000s.

Hulbert found two other newsletters that indicated more stock declines, but strangely enough the model portfolios they published stayed heavily in stocks.

As Buffett concluded: "I continue to believe that short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in the market like children."

"Short-term market forecasts are poison and should be kept locked up in a safe place."

THRIFTY KIDS, JIM CRAMER'S SKILL, & MORE

Today's children might be better savers than their parents, shows a survey by life insurer Northwestern Mutual.

Fifty-four percent of those under 29 in the survey said they would save money until they could afford an item they spotted in the mall.

Only 42 percent of those over 29 would save up, while a larger percentage of the older respondents would buy immediately on credit.



Jim Cramer's record

Mad Money's Jim Cramer issues buy and sell recommendations to his audience on each show. Just how good are those recommendations?

Two professors at Northeastern University performed several statistical tests to see if Cramer beat an appropriate benchmark and whether he generated additional return for the risks he takes.

The result? He adds no value, nor does he hurt those who follow his advice. "He's

harmless," concluded Professor Paul Bolster, who conducted the study with Emery Trahan.

529 plans help

Parents who own 529 plans are the most successful in saving for college, found a survey by the College Savings Foundation.

About two-thirds of those who use the plans have saved more than \$5,000 per child, while just 22 percent of parents who save elsewhere had accumulated that amount or more.

It says families should save an average of 5.7 percent of their incomes for college.



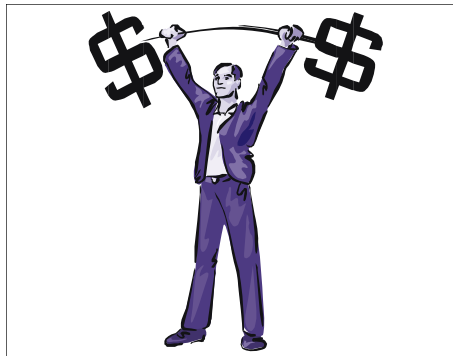
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RETIREMENT INVESTORS HAVE THEIR WORK CUT OUT FOR THEM

"It's clear that American families are going to need to drastically increase their savings, work longer or significantly decrease their spending in retirement if they hope to make ends meet," says Craig Copeland, of the Employee Benefit Research Institute and author of a new study on retirement preparedness.

Copeland used figures on household and employee retirement savings compiled by the Federal Reserve through 2007. He then made estimates of those same amounts as they stood in June, taking into account the effects of the 2008 bear market.

His conclusions were alarming. Employees who contribute to their employer's defined contribution retirement plans had a median plan balance of \$31,800 at



Retirement savers need to do some heavy lifting in order to recover from 2008.

the end of 2007. By June of this year, he estimated those balances had declined by 16.4 percent to \$26,578. Losses were even higher for families with more than \$100,000 income: he estimated they lost 22 percent.

The median value of individual retirement accounts was \$34,000 in 2007, but had probably dropped to 15 percent to \$28,955 by

June of this year, he said.

"Americans have a great deal of work to do, after the tremendous loss of wealth in 2008, to ensure financial security in retirement," he concluded.

He noted one bright spot: employees and other retirement savers who continue to make regular contributions to their accounts will benefit as the stock market recovers from 2008.

This is very important: portfolios recover quicker after downturns if new money is put in at the market's (temporarily) lower price.

Workers who made regular contributions to their plans last year as prices fell bought more shares at cheaper prices. This year, as the market has recovered swiftly, those shares added an extra boost to their accounts, making for a quicker recovery.