

MaxOut Savings Report

With Ted Geoca

www.maxoutsavings.com

MaxOut Savings Advisors, LLC

05/17/2011

SAVE AGGRESSIVELY AND INVEST CONSERVATIVELY!!!

Income and Inflation

Income and Inflation

5% or 4.5%?

Income vs. Capital Gains

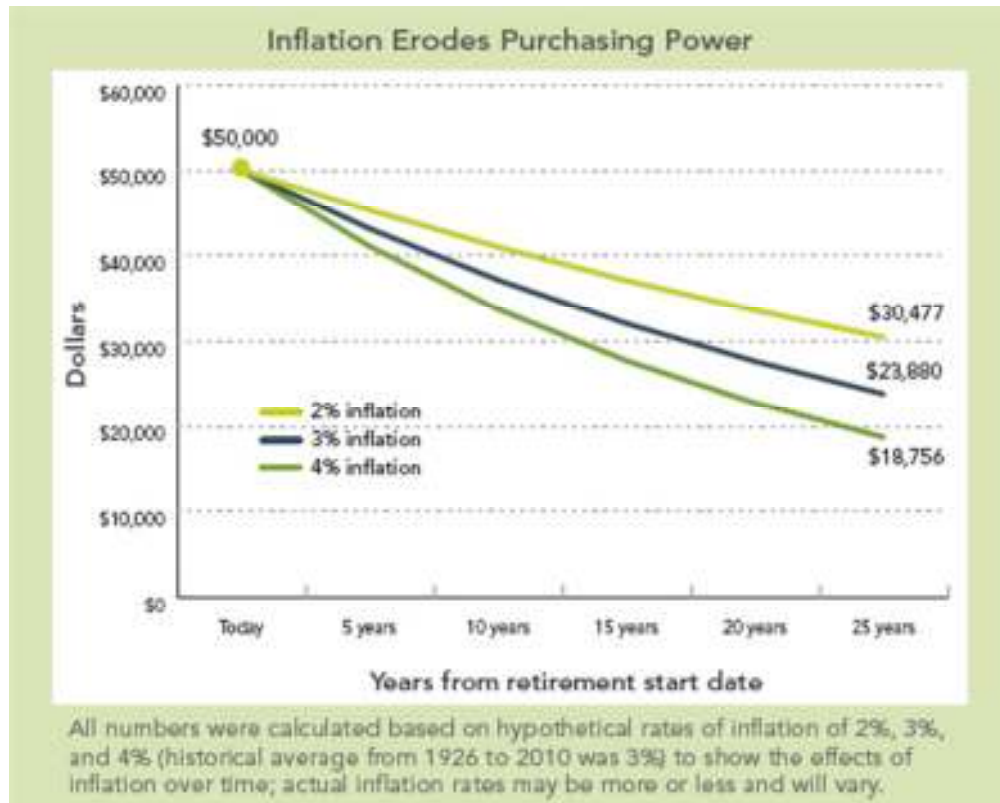
Milken Global Conference

Complacency

China & Commodities

How much income can I expect to generate from my retirement plan at retirement? This is an age old question whose answer has changed over the last century. In 1935 the average life expectancy was 61.7 years. For 2009, life expectancy had extended to 78.1 years. People are now expected to live an average of over 16 years longer. This means we need to plan for several decades of income because many people will live much longer than the average. A married couple now has a 25% chance at least one of them will reach age 97!

Therefore we need to not only plan for income but also grow the income over a possible thirty year time frame. The chart below shows the effects of inflation on a \$50,000 income over several decades. So the first thing we must understand is that we must grow the income over time or inflation will substantially reduce your standard of living. This is why inflation is materially more dangerous than deflation. During the Depression we had deflation so while there was a serious decline in portfolios, there was also a material decline in costs. One needed less income to pay for food and other goods. During the inflation era of the 1970s, portfolio values went down, as did the ability to generate income, and living costs went up because of inflation. **Inflationary recessions are much more damaging to your retirement standard of living.** For a retirement portfolio it is important to produce income and growth over the long term to keep pace with inflation. This is why we recommend a reasonable weighting of stock not just bonds in your retirement portfolio.



5% or 4.5% Inflation Adjusted Income

There have been several studies that have looked at the proper amount to take out of an account for retirement income. Fidelity did a study using a portfolio of 50% stocks, 40% bonds and 10% cash. Using a 5% withdrawal rate plus an adjustment for inflation each year and running a century's worth of returns using Monte Carlo simulations, you have about a 74% chance of the income lasting to age 90. The Monte Carlo simulations ran through the Depression and inflation of the 1970s.

Another study in the 1990s was done by William (Bill) Bengen for the Journal of Financial Planning. It found that a 4.5% inflation adjusted withdrawal rate was a more ideal number. The 1994 study assumed a 50/50 stock to bond ratio and the withdrawal rate indexed to inflation. Bengen now recommends a 55% stock weighting to better handle inflation. For a taxable account, he recommends a 4.1% withdrawal rate to adjust for the annual drag of taxes. The annual tax savings in a tax-free IRA or qualified account allows you to have a higher withdrawal rate over time.

Income vs. Capital Gains

These studies also bring out the point that it is often better to use a set income withdrawal rate instead of simply drawing income out of the account as it comes in from interest and dividends. Using income only from dividends and bond interest tends to skew a portfolio to the shorter term and will not allow capital gains over the long term to support income growth over time. So while initially you may be able to generate a higher withdrawal from income, over time without capital gains, inflation will reduce your standard of

living. In a retirement portfolio you want to construct the investments to yield income and long term growth. At MaxOut Savings Advisors, we typically recommend a 60% stock/ 40% bond portfolio to achieve the long term goal of income growth.

Milken Global Conference

The Milken Institute Global Conference is always an intense experience with over 150 panels and some of the brightest minds in investment management, politics and academics (ok they did somehow let me in). It is a great place to find new ideas and discover what people are thinking. Last year the title of the conference could have been “kick the can down the road” for all intents and purposes, with the idea that we got through the Wall Street financial collapse by papering over the problems and kicking the can down the road. This year it should have been titled, “Complacency”!

I heard a lot about the problems, everyone just seems to assume they would work themselves out.

The first Panel was titled: “The Shape of Things to Come” Mohamed El Erian lead off talking about the many problems we still have. He said that there are many potential outcomes possible and a good possibility of more crises. This is a key point in that the world is much less predictable. This is why we so often talk about the need to have a much more risk-focused investment strategy that will handle a number of different outcomes. Laura Tyson, a former White House economist, mentioned that Greece “has not been making their numbers”. What she meant is its austerity program is failing. She did not say it but this is why Greece has been downgraded. A number of people on the panel said that Europe cannot let the PIGS (Portugal, Ireland, Greece and Spain) default and that they would work this out over time. And so began the complacent talk. Mohamed pointed out that Germany, emerging markets and the US consumer were doing well; high oil prices, housing dip and Europe were problems.

Nouriel Roubini’s panel was interesting as always. He was upbeat on the US economy. Over time he was concerned about China, stating that over 50% of China’s GDP was fixed investment and once this number gets this high it is almost impossible not to have an economic slowdown once that investment slows. Every other economy that got to that ratio of fixed investment to GDP has had a steep recession. He believes that soon the “bond market vigilantes” will wake up and take US interest rates higher because of our massive government deficit spending. He thought that this bond market revolt would happen by 2013 unless something drastic is done politically to control deficit spending. A common theme throughout the conference was the need to get government spending under control.

One of the themes coming out of the real estate panel was that REITs had recovered in price but real estate itself had not. In many cases the REITs were trading for more than the underlying real estate was worth. The general feeling was that exchange traded or public REITs were overvalued.

On one of the fixed income panels chaired by Michael Milken, the consensus was that government, corporate and particularly high yield bonds were generally overvalued. Distressed mortgage debt seemed to offer the best value and emerging market debt was fairly valued. The Fed is artificially keeping rates low and that hurts returns. One of the panelists did a study of Federal Reserve buying for QE and stock market returns. On the days the Fed spent over \$100 million the S&P 500 was up 37% and on the day the Fed spent less than \$100 million the market was up only 6% in total. The lesson was that QE by the Fed is moving the stock market higher.

There was a lot of talk about China. China is shadowing our Fed policy by holding the Yuan at the same level as the US dollar. By shadowing the Fed they have been effectively importing inflation into China. Inflation has become a huge concern for China as it is leading to civil unrest. The question will be whether or not they can halt inflation without causing a recession in China. The jury is still very much out on that and we will get an answer to that in the near future as they are trying very hard to slow inflation.

Europe was a big concern with Greece and Ireland, although again many seem to think we would work through the problems with little disruption. There was general agreement from all sides that Greece and Ireland would have to default or “restructure” in one form or another because they could not afford to pay their debts. Ireland for instance owes about \$240,000 for every person in Ireland! This compares to a little over \$40,000 per capita in the United States. Overall it was a great conference. My impression was that there was a complacency that this would all work out over time. I am not sure we have that much time and if that is the case, many investors are not positioned for that potential outcome.

China & Commodities

Jeremy Grantham’s recent quarterly letter at GMO.com had a great chart that shows us who is driving commodity prices: China. As can be seen below China is consuming almost 40% or more of the worldwide demand for cement, iron, coal, pigs, steel, lead zinc, aluminum and copper. China is consuming this percentage of the world’s commodities while accounting for only 9.4% of the world’s GDP! Jeremy believes because of population growth, we are in a long term commodity bull market. The chart also highlights a concern of ours that **if China’s growth falters, some commodity prices could fall substantially.**

Commodity	China % of World
Cement	53.2%
Iron Ore	47.7%
Coal	46.9%
Pigs	46.4%
Steel	45.4%
Lead	44.6%
Zinc	41.3%
Aluminum	40.6%

Copper	38.9%
Eggs	37.2%
Nickel	36.3%
Rice	28.1%
Soybeans	24.6%
Wheat	16.6%
Chickens	15.6%
PPP GDP	13.6%
Oil	10.3%
Cattle	9.5%
GDP	9.4%

As we can see from the above table, China, with only 9.4% of the world's economic GDP, is an outsized user of many commodities. This is one reason when it comes to commodity investing we like oil, natural gas, gold and silver because their usage is much more diversified around the world and not overly dependent on China for demand.

Outlook

We continue to be concerned about the end of QE2 by the Federal Reserve on June 30. Since September of last year until June 30 the Fed will have pumped in \$600 billion into the economy. During that time the stock market has gone up over 25%, QE2's biggest success is moving stock prices higher. That is now coming to an end and will not be positive for the stock markets. The stock market is beginning to anticipate the end of QE2 which is why it has gone nowhere over the last month. In addition the problems in Greece and Ireland appear to be worsening. Greece's austerity program has begun to fail. Both of these countries will have to restructure their debt. We believe that the US housing market has entered into a double dip caused by a surge in foreclosures that will be hitting the housing markets into the second half of the year.

On the positive side overall manufacturing in the United States has recovered quite nicely. We believe that many companies will move additional manufacturing capacity to the United States to prevent future supply chain disruptions after what happened in Japan with the earthquake. Many companies were caught flatfooted by supply problems caused in Japan. Overall we remain cautious in our investment outlook; this debt crisis, as we have written about, will take a number of years to correct. We want to use corrections in the investment markets to invest in value when we find it. To do that you need to maintain higher than normal cash levels.

Do you have an account at Fidelity?

Do you already have an account at Fidelity Investments? The MaxOut Savings Advisors Team can actively manage the assets for you at Fidelity. We will make the investment decisions for you and you can monitor your account from Fidelity's website. We use the same value based investment strategies we talk about on the MaxOut Savings Show. In most cases, you can sign a simple form to add us as the advisor on your account and we can use your existing Fidelity account number.

Considering an IRA Rollover?

If you are retiring soon or considering an IRA rollover, let the MaxOut Savings Advisors Team handle your IRA rollover. We can help you take advantage of the NUA tax break if you have low cost basis stock in your company plan. We will sit down with you, discuss your financial situation and needs, and develop a plan tailored specifically for you. We will show you how we manage our accounts using our value analysis strategy to grow the investments and reduce risk.

MaxOut Savings Advisors: Actively Managing Risk

In these volatile times, investing your retirement funds can be difficult and time consuming. Is your advisor looking at risk and actively managing your retirement? Hiring the MaxOut Savings Advisors team to manage your money or IRA rollover is a great first step toward a successful retirement. MaxOut Savings Advisors is an SEC registered, fee-only investment advisor based in Houston, Texas. Ted Geoca has over twenty years of investment experience managing clients' retirement assets. We invest in stocks, bonds and mutual funds for our clients using a value analysis strategy that we have developed over the last couple decades. **We look at risk as well as return to actively manage your investments and maximize your returns through today's changing markets.** We use Fidelity Investments as the custodian for our clients' assets. If you would like MaxOut Savings Advisors to manage your retirement investments using our value methodology, I would be happy to meet with you. To schedule an appointment please give us a call at 713-627-0400 or email me at ted@maxoutsavings.com.

Remember Save Aggressively and Invest Conservatively!

Ted K Geoca

President

MaxOut Savings Advisors, LLC

Houston, Texas

ted@maxoutsavings.com

www.maxoutsavings.com

Kellan Caldwell

Doug Saam

713-627-0400

Remember to catch:

The *MaxOut Savings Show with Ted Geoca* on Saturday at 11:00am on KNTH 1070AM!

The MaxOut Savings Show and Report does not give out financial advice. Any recommendation may not be suitable for all investors. Moreover, although information contained herein is believed to be reliable, its accuracy cannot be guaranteed. MaxOut Savings Advisors, LLC may or may not have positions mentioned herein. MaxOut Savings is a Registered Investment Advisor registered with the SEC. You should always make investment decisions based on your own financial situation.

To sign up a friend for our free MaxOut Savings Report or to remove your name off the MaxOut Savings Report list, email ted@maxoutsavings.com.