



Stephen Molyneaux

STAYING INVESTED

History Supports The Theory of Never Fully Abandoning Equities

In Benjamin Graham's book, *The Intelligent Investor*, which Warren Buffet said was by far the best book about investing ever written, Graham asserts his theory that investors should never be more than 75% invested in stocks and never less than 25%. One of the central tenets of Graham's general portfolio policy was that an investor's portfolio should always consist of a varying blend of stocks and bonds. The blend or ratio of stocks to bonds would vary depending on market conditions. The ratio of holdings may vary, but would never exceed the point where an investor held more than 75% in either equities or bonds and would also never fall below the threshold of holding less than 25% in either asset class.

Investors Should Never Be More Than 75% Invested In Stocks and Never Less Than 25%

With the current severe downturn in the market, it is tempting for some investors to question whether they should stay invested in equities or alternatively sell out of the market and return when the economic outlook improves. We thought it may be an appropriate time to look to history to see how investors fared in other dramatic recessions by either staying invested in a certain percentage of equities or by following the more speculative model of timing the market by exiting markets in a downturn and then attempting to return when things improve.

Investor Losses in The Great Depression Were Neither Universal Nor Uniform

The Great Depression remains the American embodiment of financial ruin. During this grim era spanning 1929 to the start of WWII, unemployment was over twice the rate which we suffer today and the economy was in total shambles. When the depression started, the stock market sank into a deep bear market which lasted four years (1929 to 1932). During this dramatic bear market, large cap stocks lost 64% of their value. But a detailed and thoughtful examination of the market data surrounding the Great Depression demonstrates that investor's losses were neither uniform nor universal – not everyone was wiped out or even suffered the severe losses as is often portrayed by popular contemporary commentators. In fact, certain investors, holding a blend of equities and bonds in a well-diversified portfolio, were able to weather the Great Depression in relatively good shape.

The included asset class performance table (see page 3) demonstrates that while large cap stocks did plummet 64% from 1929 to 1932, it also shows

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Laurence Burnette, CFP

RETIREMENT ACCOUNT TAX CHANGE FOR 2009

Changes Allow Retirees More Flexibility With Their RMDs

Make Sure Your Withdrawal Requests Are Being Acted Upon Properly

Recent legislation (The Worker, Retiree, and Employer Recovery Act of 2008) offers those approaching or older than 70½ more flexibility regarding required minimum distributions (RMDs) from their IRA or other qualified retirement plans such as a 401(k) or 403(b).

The legislation allows those investors that have reached 70½ or older to skip taking their required minimum distributions (RMDs) from their traditional individual retirement accounts, 401(k) and 403(b) for tax year 2009. In any other tax year, those same investors would have been required to take withdrawals from their retirement accounts and pay taxes on the distributions. ***The Recovery Act only applies to tax year 2009. Investors must take their required withdrawal in tax year 2008 and resume taking the withdrawal again in tax year 2010.***

For most people it probably makes sense to leave the money in your retirement account this year if you can afford to do so. The money will grow tax-deferred for the year and you will not have to pay any income tax on it. The intention of the new legislation was to allow time for investors to potentially recoup some of their tax-deferred balances that have declined due to recent market declines. Some investors, especially those with a large retirement plan, may benefit from taking their withdrawals in 2009 even though they are not mandated and the investor may not need the money. Investors with sizeable retirement accounts may find it financially advantageous to take their withdrawals in 2009 so as to not prompt a larger tax bill in future years. The IRS mandatory withdrawal schedule is based on life expectancy, much like an insurance actuarial table. As the retiree ages, the withdrawal amount is adjusted upward to reflect the remaining life span of the retiree. By postponing your withdrawal in 2009, you may discover you will be required to take larger withdrawals in subsequent years, and that will push you into a higher tax bracket. Ultimately, the correct decision depends on your individual tax situation. It goes without saying, if you are uncertain of the tax implications of whether or not to take a withdrawal in 2009 – consult your tax advisor or financial planner before making a decision.

Postponing Your 2009 RMD Withdrawal This Year May Require You To Take Larger Withdrawals In Subsequent Years, And May Push You Into A Higher Tax Bracket

Keep in mind while planning your budget, taking a withdrawal in 2009 is not an all-or-nothing proposition. Under terms of the Recovery Act, investors are free to take only a portion of their planned RMD in tax year 2009 and allow the remaining balance to potentially grow tax-deferred. Also remember, any withdrawal, regardless of size, taken from your traditional IRA or qualifying retirement plan balance will be subject to income tax.

One final note to investors: A recent Wall Street Journal article (*New IRA Law Bewilders Investors*, February 11, 2009) highlights the numerous problems some investors have had adjusting their RMDs with various administrators and custodians. Apparently, more than a few IRA custodians are bewildered by the new law and are seeking guidance from the IRS. The central theme of the article was for investors to make sure their withdrawal requests are being acted upon properly by their administrator or custodian. A 73-year-old retiree quoted in the article probably best summed up the situation when she said, “It’s all so confusing.”

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This column is provided by Laurence C. Burnette, CFP, and a member of the Financial Planning Association

the sharp (nearly 200%) rebound they enjoyed from 1933 through 1936. The only investors who suffered permanent, severe losses were those who abandoned their equity holdings during the dramatic downturn. The holder of a well-diversified portfolio of equities and bonds who stuck with them through thick and thin actually did reasonably well during this bleak period in history.

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Asset Class Performance, 1929 - 1945

	LARGE STOCKS	SMALL STOCKS	LONG-TERM GOVERNMENT BONDS	TREASURY BILLS	INFLATION
1929	-8.4%	-51.4%	3.4%	4.7%	0.2%
1930	-24.9%	-38.1%	4.7%	2.4%	-6.0%
1931	-43.3%	-49.8%	-5.3%	1.1%	-9.5%
1932	-8.2%	-5.4%	16.8%	1.0%	-10%
1933	54.0%	142.9%	-0.3%	0.3%	0.5%
1934	-1.4%	24.2%	10.0%	0.2%	2.0%
1935	47.7%	40.2%	5.0%	0.2%	3.0%
1936	33.9%	64.8%	7.3%	0.2%	1.2%
1937	-35.0%	-58.0%	0.2%	0.3%	3.1%
1938	31.1%	32.8%	5.5%	0.0%	-2.8%
1939	-0.4%	0.3%	5.9%	0.0%	-0.5%
1940	-9.8%	-5.2%	6.1%	0.0%	1.0%
1941	-11.6%	-9.0%	0.9%	0.1%	9.7%
1942	20.3%	44.5%	3.2%	0.3%	9.3%
1943	25.9%	88.4%	2.1%	0.3%	3.2%
1944	19.8%	53.7%	2.8%	0.3%	2.1%
1945	36.4%	73.6%	10.7%	0.3%	2.3%
Average (no compounding)	7.4	20.5	4.7	0.7	0.5
Compounded Average	3.5	7.6	4.6	0.7	0.4
Growth of \$1	1.8	3.5	2.14	1.12	1.06

From: Wealth, War, and Wisdom
 Source: Ibbotson; Traxis Partners



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Hanover Advisors is pleased to announce a blog is now available on our website. The blog will be updated on a regular basis with pertinent, up-to-date investment commentary regarding portfolio adjustments and unfolding events in the financial markets. Please visit our website at www.hanoveradvisorsinc.com to view our newest feature.

From the beginning of 2008, stocks have already lost roughly 52% of their value. In the deep bear market of the Great Depression, stocks lost about 64% of their value – only 12% more than the pricing of today’s market. Today’s stock prices have discounted or lost nearly 80% of the terrible losses which were seen during the Great Depression. Unless an investor firmly believes that today’s economy will deteriorate to levels even worse than during the Great Depression, it would make no sense to abandon equities at their present price. By leaving the equities market at today’s prices, an investor will not only ensure the temporary losses they have already suffered will become permanent losses, but the investor will miss out on any of the very sharp gains which historically have followed severe bear markets such as during the Great Depression.

The Only Way To Know When A True Bottom Is Reached Is 3 to 6 Months After It Has Been Established

The unnerved investor of 1932, who after suffering four years of falling stock prices finally threw in the towel and quit the equities market entirely, must have felt dreadful as the market began to dramatically rebound in 1933. Consider the data from the years of 1933-1936 as the market began to recover. Large cap stocks gained 54% in 1933, dipped -1.4% in 1934, gained 47.7% in 1935, and finished this four year period by gaining 33.9% in 1936. Small cap stocks had even more impressive gains from 1933 to 1936 – with 1933 showing a whopping 142% gain. Yet the investor who quit the equities market in 1932 never realized any of these gains.

If we examine the data from 1929 to 1945, we see the best year for returns during this 17 year span was 1933. The market soared quicker after the four dismal years of 1929 to 1932 than at any other time during this entire era, yet few if any at the time knew that this was the true bottom. Investors awaiting an upturn in the overall economy before re-entering the equities market would have missed out on most of the early and tremendous gains.

Market rebounds seldom correspond with an uptick in the economy – they precede it. The market tends to look forward – most often, today’s news has already been factored into prices. The only way to ever really know when the true bottom has been reached and stocks are on a sustained rebound is about 3 to 6 months after the rebound has occurred.

It is very difficult to watch the value of your portfolio drop in a severe downturn, but numerous historical studies have shown that maintaining some exposure to stocks in a well-diversified portfolio is the best strategy. Investors should keep a long-term view of investing and follow Graham’s advice of never fully abandoning equities.

Frank Johnson will return in our next newsletter with an article regarding converting part or all of your traditional IRA to a Roth IRA in consideration of proposed changes in the tax code.

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