YOSEMITE CAPITAL MANAGEMENT

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COMMENTARY

"Good judgment comes from experience, and a lot of that comes from bad judgment." – Will Rogers

Many approaching retirement are finding their savings are not large enough to support the retirement they want. Thus they have to make some major changes to severely cut back their present lifestyle, reduce expectations for how they will live in retirement, or work longer. Often a combination of these is necessary.

People in any sort of predicament often think "I wish I knew then what I know now." And while making mistakes can provide great teaching moments, another way to learn important lessons is by studying the mistakes of others. Because retirement is perhaps the largest expense for which Americans in every generation must save, we thought we would direct this essay to younger folks in order to help them mitigate their mistakes. Or at the very least they can't say nobody told them.

Because young people may perceive retirement as a vague notion that is a few decades ahead and they don't have to think about it now, it is important to realize that the greatest advantage in preparing for anything far from now is the TIME they have because this allows the power of COMPOUNDING to work its magic on their savings. One of the biggest regrets many retirees have, and those close to retirement that are facing some not-so-pleasant choices, is ***the mistake of not saving earlier*** for this phase of their lives.

Yes, young people have current expenses they must deal with that makes it difficult to keep ahead of their paychecks, including paying off student loans, saving to buy a house, etc. But the key point is to at least get started by ***getting into the habit of saving*** something for retirement, even if small.

Many have a 401(k) plan offered by their employer that is a great place to start because people don't miss money automatically saved every paycheck by payroll deduction since that money never hits their checking account. While saving the maximum allowed is ideal, other obligations may force a more practical limit. Aim for 10% of gross income if possible, or gradually get to that point starting from, say, 5%, over a few years. At the very least, contribute enough to maximize the match because this is free money with an instant return on investment.

With this start, there is a classic example that demonstrates the power of TIME and COMPOUNDING. Assume Mary saves $5,000 per year starting at age 25 and stops saving after 10 years (thus contributing $50,000 total), then retires at age 65. Assume Joe saves the same $5,000 per year starting at age 35 for 30 years (thus contributing $150,000 total), then retires at the same age 65. In both cases, assume an average annual return on their savings of 7%. Who has more for their retirement at age 65?

Even though Joe saved significantly more over the years and ended with $505,365, Mary's significantly fewer savings ended at a higher total of $562,683 because of compounding over a longer period of time.

Note that anybody can run this exercise using a financial calculator or a spreadsheet with their own savings amounts, time periods, and rates of return to suit whatever scenarios one wants, but the lesson remains the same: ***compounding is powerful over the course of time***. Therefore, ***TIME is the most significant asset that young people have*** when building a retirement portfolio. Time can overcome relatively small amounts of capital and even lower rates of return.

The later one waits to save, the more important capital and rates of return become in order to achieve goals. The problem with depending on saving more capital at a later time is that the money may not be there when planned, as sometimes life happens and foils even the best intentions. Higher rates of return usually require taking more risk, either through a more aggressive asset allocation and/or security selection, but naturally this also increases the odds of shortfalls. It is especially important to understand that just because one takes more risk does not necessarily mean higher returns must occur. Of course, higher rates of return can also happen if the financial markets simply perform better than expected, but this is completely out of one's control; hope is not a strategy.

Those who lament "I wish I knew then what I know now" about their retirement wish they knew then to save early. Getting into the habit of saving is important, even if the amounts seem small, so that they can grow into their needed contributions over time. At some point, though, the savings have to be somewhat substantial because even the best investment plan means nothing without sufficient capital. Harken the adage, ***"If it doesn't hurt, you are not saving enough."***

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We again remind clients and friends that the stock market is overdue for some volatility. No one can consistently predict when or to what extent the stock market will decline or the trigger for such an event. But a decline WILL happen if for no other reason than because that's what markets do. WHEN this happens, remember that higher volatility is NORMAL. The relatively long period without volatility is what is abnormal.

A decline is coming, so mentally prepare now.

For those who are growing their assets for future use, such as retirement, remember that portfolio statements showing a lower balance than at a previous time is very likely both short term (less than three years) and temporary. Additionally, a lower stock market provides opportunities to buy securities with future contributions at lower prices.

For those who are in retirement and taking distributions from their portfolios, remember that cash flows are not affected by the gyrations of the financial markets. This is especially because the proportion of stocks in a properly designed portfolio is already at a relatively low number. The remainder of the portfolio is in fixed income, which often increases in value when the stock market falls and thus mitigates portfolio fluctuations.

Most importantly, regardless of the current purpose of a portfolio, make sure your long term strategic plan as exemplified by the percentage mix of stocks and bonds is still appropriate for your circumstances. This mix of stocks and bonds already prepares you for an appropriate temporary reduction in the market value of your portfolio that your situation can handle. If your long term strategic plan is not appropriate for your circumstances and risks need to be reduced, now is the time do so. Note that a long term plan should never be changed simply to avoid a market decline that will very likely be both short term and temporary.

A concluding thought: ***The financial markets don't ruin a retirement, only bad behavior does***.

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John Kleponis, CFA
Chief Investment Officer

Paul Heckler
Managing Director

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