Marathon Investment Management

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Dividends all the Rage?

By: Amy Mahlen

Many professionals and media outlets are pushing dividend investing as a cure-all for investors given the dire interest rate environment – essentially swapping bonds for stock. There are many reasons to invest in dividend paying stock (many of our quarterly letters have outlined these benefits). However, swapping one investment type (bonds) for another (stock) will modify a portfolio's risk profile. Just like with any investment, it is critical to understand the differences between these structures and therefore their risk-reward relationship <u>before</u> jumping on the band wagon. Remember that the only 'for sure' investment is a 20/20 hindsight investment; otherwise it may just be too late.

Effects of Interest versus Dividend

Many investors who may be considering this switch are retirees desperately trying to increase their income. One common objective during retirement is to avoid dipping into savings that have been accumulated over a lifetime (principal), live off of the earnings generated, thereby preserving future income payments.

When a bond is held until maturity the principal remains intact and the investor receives a constant income stream. Dividend stocks are substantially different because throughout the holding period the dividend payout affects the price of the stock – which essentially is the stock's principal. For example, when a $10 stock pays a 25 cent dividend (2.5% quarterly dividend yield), the price of the stock will automatically adjust to $9.75 in order to compensate for the payout – lowering the principal and total value of the stock. Even though the investor is left with the same total amount of money after the payout ($9.75 stock plus $0.25 cash dividend = $10) he/she is left with less if the dividend is spent and not reinvested.

The good news is that the number of shares that the investor holds will remain constant throughout this process. However, to compensate for the decline in stock price due to the dividend payout in order to preserve future dividend cash inflows (25 cents in this case, or a 2.5% quarterly dividend yield), the stock will either need to rise 25 cents per share or increase its dividend yield to 2.56% in order to pocket the same amount of income ($9.75*2.56% = 25 cents). Making up this difference in price is difficult during market declines and could force retirees to sell shares in order to produce adequate income – which can quickly deteriorate principal and total value over time making this strategy risky. Some companies are known for historically increasing their dividend over time but generally it is not every time the dividend is paid.

Structural Difference

Stock owners are business owners. This means they participate in the rewards (profits) a company generates through stock price appreciation yet fully experience any financial losses. All business risks (associated with financing, suppliers, economic, operations, media, marketing, etc.) are reflected in the stock owner's end results. When investors rely on dividends that are tied to all these issues, the income stream and principal are affected.

Bond holders are credit lenders. There are varying degrees of risk involved depending on the type of loan, the terms of the loan and the status of the borrower (credit worthiness, which can change). Assuming all goes well and the borrower does not default, all parties get what they signed up for - what is expected. Fluctuation in the bond's value may occur before the bond matures from interest rate changes or the borrower's credit status. This is called an *unrealized* gain or loss. Losses may only be *realized* if the bond is sold <u>before</u> the end of the contract. Because several conditions are agreed upon at the time of bond purchase, generally speaking, bonds have been referred to as the 'safer' investment with lower returns when compared to stock.

Current Value vs. Future Value

Valuation is a sophisticated and overwhelming topic – as the core principle in investing, it should be. There are numerous methods and viewpoints to base valuation from that makes it complicated with variable results – especially concerning stock.

A significant factor that will affect the value of bonds during the investor's holding period is interest rates. If interest rates go up the bond will be less valuable. ***If*** the investor sells it during this period (because emotionally it makes sense to sell something that is losing value) he/she will actually incur a loss. However if the investor holds on to the bond and waits this period out, the bond will continue to pay interest payments, and then will mature at the end of the contract and the investor will receive what he/she anticipated (minus the bumpy ride in value).

For the past four years we have experienced historically low interest rates with the Federal Reserve (Fed) holding them at virtually zero but at some point, interest rates will rise. Given the level at which the Fed has chosen to fight this recession it is possible that interest rates could go up considerably - creating significant *unrealized* losses for bonds. This along with measly interest payments, has many believing that stocks hold the hand up as they typically do better in rising interest rate environments.

Inflation also has a negative impact on bonds because it erodes the total value of the fixed interest payments. On the other hand, stocks can fair better during inflationary periods because of their more flexible nature (i.e. the capability to increase prices, therefore revenue).

Conclusion

Bond interest versus stock dividends can lead to very different results especially in today's unique environment. Many investors become so desperate to create more income that they either put aside or ignore the major structural differences and the various forms of risk associated with each investment. There will always be unknowns regarding investing - in order to be good at it you must minimize the unknown. Remember, call us – we are here to help!

Keeping You Protected

By: Polina Nilva

We live in a technological world where we depend on internet and social media for everything. Advances have vastly improved the way we communicate, obtain information, bank, and even shop. Unfortunately, with this improved freedom, there can also be harmful side effects. As personal information becomes more readily available online, cases of identity theft and fraud have risen. Social media and e-mails have become a gateway to easily obtaining personal information. It can happen to anyone; however, there are ways we can remain vigilant and prevent identity theft, by way of physical and cyber threats, from occurring[1]:

- Do not open e-mails from unknown senders as well as any attachments from said senders. Thieves send out viruses in e-mail attachments which you might not even realize you have. This would give them access to everything on your computer. Do not open suspicious e-mails even if they are from someone you know as they may have been sent by a third party.
- Read your account statements carefully. Make sure there are no charges that you have not authorized.
- Shred any mail with personal or account information before throwing it out.
- Do not leave any personal or confidential information on social media sites. Do not let people know you are going to be gone from your home for a certain period of time. This would give perpetrators a window of opportunity for a robbery.
- Keep all valuable documents such as social security cards, passports, birth certificates, passwords and log-in information in a locked place such as safe or a safe deposit box at the bank.
- Use different passwords and log-in names in various online banking sites. It is recommended you change your internet passwords every three months.
- Do not give out any personal information to anyone who is claiming to be your financial service provider without showing proof or to anyone who claims to be a distant relative in need of money.
- Do not wire money over the phone or over e-mail to anyone unless you have solid proof of their identity.

According to the Federal Trade Commission, take these steps if you have been a victim of identity theft[2]:

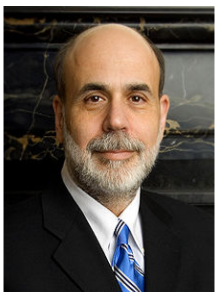
- Place a fraud alert on your credit reports, and review your credit reports.
- Close the accounts that you know, or believe, have been tampered with or opened fraudulently.
- File a complaint with the Federal Trade Commission.
- File a report with your local police or the police in the community where the identity theft took place.

The Marathon Investment team, along with our custodians, Charles Schwab and TD Ameritrade, will strive to prevent any possible security breach. To maintain and provide the greatest protection for our clients, we will not accept e-mail requests for money transfers without confirming with the client first. Please remain aware of your confidential financial and personal information. Together we will do our part to curb identity theft and fraudulent transactions.

Footnotes:

1. Investor's Business Daily, "Protect Yourself From ID Theft," pg. A11, 1/14/13
2. www.ftc.gov, "Defend: Recover From Identity Theft"

If you were to ask a group of diverse people of varying ages and backgrounds to identify the person in each photo below, it would be interesting to see the number of younger respondents who could correctly identify the gentleman on the right vs. the "icon" on the left.



Saving for a New Generation

By: Karree Moore

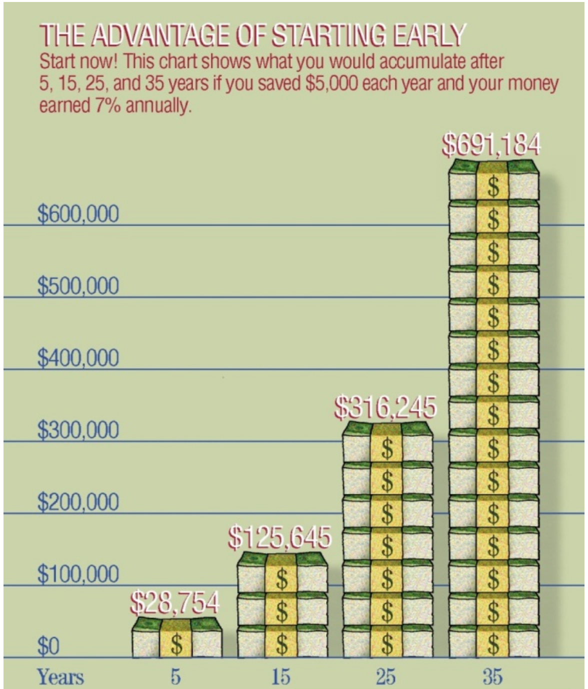
I was recently surprised to hear a description of Generation Y as the, "self-entitled group raised during prosperous economic times, placed on pedestals by their doting baby boomer parents."[1] If that was indeed an accurate representation of those born between 1979 and 1991, is it surprising to assume most young respondents would without thought name the reality TV starlet, Nicole "Snooki" Polizzi, and be clueless as to who Ben Bernake is?

Interestingly enough, however, few of today's young adults escaped childhood free of financial worries – either direct or indirect. The eldest of this generation were in kindergarten in 1984 when the Bureau of Labor Statistics first began to record worker displacement in response to widespread layoffs[2]. They were in elementary school when families experienced 1987's Black Monday and the recession of 1991. Those paying attention during the late nineties saw the dot-com bubble go from boom to bust! More recently there was the Enron debacle, then 9/11, and the housing bubble followed by the economic recession and record high unemployment numbers.

Perhaps, it is more accurate to say that Generation Y has never experienced a sustained period of financial prosperity. Many don't expect social security to be around in 40 years, and some would argue that they are more likely to see an alien spacecraft than to ever receive a social security check. Additionally, in previous quarterly reports, George has mentioned that young people are not saving enough for retirement or even for maintaining a quality lifestyle[3].

To counter these sentiments, a December 2011 study by the Pew Research Center found that 57% of young adults ages 18-34 believe they will have (or eventually earn) enough money to lead the kind of life they want[4]. The study by Pew also pointed out that economic hardship has not dampened the spirits of younger adults and they maintain a sense of optimism about their financial future. More young people are discovering that the earlier they start saving and the longer they work, the larger their nest egg will be[5]. Given this optimistic outlook and considering the economic times we are currently experiencing, at Marathon, we point to the adage, "Pay yourself first."

It's safe to say that saving for retirement is important at all ages. However, most individuals begin to undertake serious money management responsibilities after leaving their parents to be on their own. This is a critical period in financial planning for young adults, as their spending and savings habits help to set the financial foundation for their lives which includes their retirement years. Take a look as the chart below proves, the earlier you start saving the better your retirement picture will look.



Courtesy: U.S. Department of Labor

As the economy improves and unemployment wanes, Generation Y should be poised to take action. Even contributing a small amount now will go a long way three decades from now. Compounding interest as shown in the table above can transform meager savings into a considerable sum over time. One of the easiest ways to achieve this is by setting up automatic, recurring deposits to your accounts with Marathon.

Going back to the results seen in the Pew study, at Marathon we key in on the word 'believe.' We question if young people truly have a real understanding of what it will take to retire, and what it will take to "live the kind of life they want." It is our hope that our younger clients do not view retirement and personal savings with "Snooki vision." It's important to understand and be able to differentiate the reality of retirement vs. the *belief* that they will earn enough.

For our clients who are younger in spirit than in age, please pass this information on to a young person you know. We would be delighted to provide guidance and advice on how to maximize this important time in their life!

Footnotes:

3. Deloitte Consulting LLP (www.deloitte.com), "Generation Y: Powerhouse of the Global Economy" 2009 report
4. U.S. Bureau of Labor Statistics, "Worker Displacement: A Decade of Change" April 1995 Monthly Labor Review
5. Marathon Investment Management, 1Q 2012 Quarterly Review by George Gumbiner
6. Pew Research Center (www.pewsocialtrends.org), Dec. 2011 Social and Demographic Trends study
7. The Boston Globe, "Generation Y looks far ahead, to retirement," Dec. 2012

IMPORTANT NOTES

1. 1099 Forms will be mailed to clients from the respective brokerage firms beginning the middle of February. In most cases Marathon can provide you or your accountant with the cost basis information to aid in your return. We also provide a schedule of management fees paid. Give us a call if there is any way we can help!

2. The deadline for **2012** contributions to Traditional IRAs or Roth IRAs is April 15, 2013. If you have not yet sent in your 2012 contribution you have until this date to deposit funds in your account.
    a. The maximum contribution for 2012 is $5,000. For those ages 50 and above the maximum is $6,000.
    b. Checks should be made payable to your name and mailed to our office so that we can easily track the delivery of the funds to Schwab or Ameritrade.

3. Start planning your 2013 Roth or traditional IRA contributions! **The maximum allowed has increased by $500** to $5,500 (and $6,500 if you are over 50). Call us today for information on how to set up a direct deposit to your account!

4. Have you recently changed jobs, retired, come into an inheritance, or made any other significant life changes? Please always remember to keep Marathon informed of any changes that might affect your financial plan and investment objectives.