

## Second Quarter 2014

*"To the extent that people reach old age mentally sharp, physically fit, and financially secure, the problems of individual and societal aging fall away."*

– Laura L. Carstensen  
Founding Director, Stanford Center on Longevity

When we came across the quote above it struck a chord. While our narrowly defined purpose as a firm is to help our clients and client families with the 'financially secure' aspect of aging we often find ourselves in the role of cheerleader, encouraging our clients to remain active, passionate and engaged as it has become crystal clear that a successful life is about far more than achieving and maintaining financial security.

This quarter we review the importance of using tax deferred retirement plans as a long term savings vehicle and the beauty of compound interest, both of which are powerful tools to aid you along the path to financial security. We also offer our market and economic commentary which, we are relieved to share, contains no untoward surprises. Finally for our accredited investors for whom it may be appropriate we offer a brief update on Albion Income Fund, Albion Fund 3, an investment partnership we created to seek out and invest in a diversified portfolio of cash flow generating investments in the non-public space.

I hope this letter finds you happy, healthy, and satisfied with the course your life is taking.

### **Tax Deferred Savings and Compound Interest: Great Tools for Meeting Your Retirement Goals**

In our last letter we discussed the Social Security leg of your retirement plan and reviewed several important decisions you'll face. This time we highlight tax deferred retirement savings strategies and the power of compound interest. As a nation we are dramatically under saved. The 50<sup>th</sup> percentile household; that is the household where 50% of households have saved more and 50% of households have saved less; has an average retirement plan balance of \$2,500. The 70<sup>th</sup> percentile household has a retirement savings balance of \$35,000 and the 90<sup>th</sup> percentile household has a retirement plan balance of \$239,000. These are frightening numbers. If we use a 4.2% sustainable withdrawal rate the 50<sup>th</sup> percentile household will be able to draw \$105 per year while the 90<sup>th</sup> percentile household will be able to draw \$10,040 per year. Even if we bump the distribution up to 10% of the asset value, which will almost certainly have the

consequence of causing the funds to run out well before the retiree runs out of life, the 50<sup>th</sup> percentile household still only draws \$250 per year while the 90<sup>th</sup> percentile household draws \$23,900 per year.

What can we collectively do about this challenge? The answer is simple to understand yet often extremely difficult to implement; we need all households to save and invest a much greater percentage of their annual income and we need them to begin saving when they are young and retirement is the last thing on their minds. Starting early allows investors to take advantage of one of the wonders of the world; compound interest. Compound interest allows an investor to earn 'interest on interest' as each year the capital base upon which interest is earned grows.

Suppose a struggling 20 year old manages to deposit \$2,000 per year into a Roth IRA. Yet when they turn 40 their ability to fund the plan stops so they make no additional contributions. They have contributed a total of \$40,000 over twenty years. When they retire at age 65, assuming a 7% rate of return, their Roth IRA will be worth \$476,150. Now suppose rather than starting at age 20 the individual did not begin saving until age 40 and saved an equal amount for each of the next twenty five years. At the same 7% rate of return they would have to put away \$7,035 per year to end up with the same \$476,150 at age 65.

Most employers offer access to a 401(k) or 403(b) retirement plan. Use them! And encourage the younger generation to use them too! Think not only of what you feel you can afford today but what you'd like your retirement to look like tomorrow and save accordingly. Those without access to a company plan can still set aside funds in a regular or a Roth IRA. The point is to start early and save based on the financial lifestyle you'd like to maintain in retirement not just based on what you feel you can afford today.

### **Economic and Market Outlook: More of the Same**

Despite the dismal final number for first quarter Gross Domestic Product (GDP - more on this in a moment) domestic equities marched higher during the quarter as the pillars underpinning them - interest rates (low), inflation (low), valuations (sensible), and the economy and earnings (still recovering and growing) - remain intact. Our preference for viewing the stock market through this fundamental lens is unbroken as we believe it provides the best insight into where we are and where we are likely headed. And while we recognize the ever-present risks inherent in a global economy, we also recognize that central banks and policymakers around the world will continue to support their economies and financial markets which has the consequence of providing support for risk assets.

In the first quarter the U.S. economy experienced a -2.9% dive in growth compared to the first quarter of 2013 (year-over-year growth, however, was +1.5%). But the headline was worse than reality as weather, the implementation of the new health care law, and inventory adjustments made up the lion's share of the contraction. While the first quarter GDP number indicated economic contraction the preponderance of domestic economic data since the end of the first quarter has shown significant improvement. Data points that have rebounded since last winter's Polar Vortex relinquished its icy grip include manufacturing, new orders, consumption, investor and consumer sentiment, and transportation/shipment data (like rail carloads and trucking data).

Perhaps most important in the second quarter were employment gains, which saw the 3-month average lift to approximately +272,000 jobs per month from +188,000 in the 3-months of the first quarter. The benefit of expanded employment to the economy is remarkably simple – as net job gains are made new incomes are paid and further consumption takes place. In addition, more jobs mean a tighter labor market translating into higher wage growth. This too leads to increased consumption. The virtuous economic cycle that is unleashed from a country working back towards full employment can be potent. To be clear, we are not implying that the economy is assured an aggressive and imminent take-off; unquestionably headwinds still exist. But we do expect a much better GDP trajectory for the second quarter and second half of 2014.

### **Albion Income Fund: An Income Tool for Accredited Investors**

Many of you are aware of Albion's work with "alternative assets". Alternatives are merely investments that do not trade on public exchanges like the New York Stock Exchange. Because of this, they tend to be illiquid (hard to sell). However, they can also be a nice compliment to and diversifier for a portfolio of stocks and bonds. Albion's funds offer clients diversified exposure to a broad class of investments that are otherwise difficult to access in a cost effective manner. Examples of these investments include private equity, venture capital, private debt and direct company investments. While not a match for everyone, and by regulation limited to accredited investors, we certainly want you to be aware of these investment tools and welcome a discussion on whether they might be a match for you. Specifically, Albion's Income Fund is open to new investors and is off to a very strong start. The Income Fund's goal is to provide an 8% per year<sup>1</sup>, or more, cash return.

Why did we start Albion's Income Fund? Because interest rates and yields on more traditional investments have been low for several years and may stay low for longer than many of us think. Yes, alternatives have the drawback of being illiquid but they also offer the potential for higher yields while adding diversity to your total investment portfolio. Please give us a call if you are interested in learning more about this fund or to just find out more about Albion's work with alternative investments.

<sup>1</sup> After a six-month waiting period which enables called capital to be invested and for distributions from the underlying investments to begin. There is no assurance that the 8% per year cash return will be achieved.