

Equity markets have had a phenomenal return over the past year and are starting to reach levels that indicate they are trading close to fair value. This suggests that much of the “easy money” has already been made and that dividends could make up a greater proportion of returns going forward. However, high yielding stocks can be somewhat interest rate sensitive and some of the traditionally high yielding sectors appear to be trading at an extended valuation. Therefore, preference should be given to dividend stocks that are more attractively valued and appear to have the ability to increase the dividend going forward, in our opinion.

In addition, while equity valuations on a forward basis are starting to approach their mean, estimates are still calling for fairly benign world economic growth. Should growth be better than expected, due to a stronger recovery in Europe or reaccelerating of growth in China, we would likely experience a further increase in equities.

Contrarily, corporate profit margins are currently higher than their historic averages, partially due to lower corporate interest expense. This might indicate that profit growth going forward could be challenged, as interest rates begin to rise.

The commodity market looks a little more troubling. After years of underfunding capital projects, many firms have engaged in major capital expansion. This has translated into a significant amount of new supply expected to come online in the next few years just as demand is starting to slacken in key markets, such as China.

With respect to currencies, longer term we believe that foreign exchange investments will offer compelling returns. Structural changes in many global economies appear to portend appreciating currencies. However, returns in the near term are likely to be volatile as speculation that the Federal Reserve will end its Quantitative Easing (QE) program are leading to sizable global capital flows. This is having a dramatic effect of many global currencies, especially in emerging markets.

Given the aforementioned, we continue to believe that equities should make up a greater proportion of a retirement portfolio than traditional portfolio management theory suggests. That said, one tenet of portfolio management has not changed: diversify, diversify, diversify. While equity markets look like they offer the best prospects, not all investments should be put in this basket.

Moreover, investments within asset classes should also be diversified as much as possible. It is important to realize that the goal of diversification is to maximize returns while minimizing risk, which means that a well-diversified portfolio is not likely to beat the returns of the best asset class. For example, a blended portfolio of equity and fixed income has underperformed an equity only portfolio this year. However, diversification also suggests that losses will be mitigated when the market turns. Thus a retirement portfolio should reflect maximize returns with minimizing risk.

Finally, when investing in a security, take the time to recognize why the investment is being made and how it fits within the overall portfolio; then write this analysis down. This will help you manage the short term gyrations in the market and keep your focus on the long term nature of the investment. Investors are often their own worst enemy, with emotions causing them to sell at the bottom of the market and buy at the top. By having a record of why an investment was made, a logical and hopefully unbiased decision can be made with respect to buying or selling a security.

About the author: Jeffrey S Witt CFA, CIPM, serves as the chief investment officer at Private Asset Management, Inc. where he leads a team responsible for the allocation of the firm's assets. Witt graduated cum laude from the University of Colorado at Boulder with a B.A. in Economics and a B.A. in Philosophy of Law. In September 2002, he was awarded the Chartered Financial Analyst designation. He has experience working as a financial analyst in the municipal bond arena for the City of San Diego and as an equity research analyst for Hanifen Imhoff. He has served on a number of boards, including as the president of the CFA Society San Diego.

Physics and your retirement savings

How energy reserves are like the world's collective retirement account

By Tim Garrett

All of us at some point hope to enjoy retirement. Yet we also face uncertainty about the future. Maybe we can adapt to a changing retirement income, even if it is for the worse. But it would certainly help if we could plan.

It would seem strange here to think that the field of physics might have anything to say about retirement planning. But I believe it can provide some useful insights for the coming decades.



Tim Garrett.

I am a physicist with a specialization in the atmospheric sciences. I became interested in the problems of economics and finance by way of studying another long-run concern: climate change. Around the time of the documentary “Inconvenient Truth,” atmospheric scientists were occasionally asked to speak publicly about the science of global warming and to offer social prescriptions.

While what came to be known as “Al Gore’s” film was unpopular with many, I rather admired how some rather challenging physics was presented for a general audience. Yet, with most of my scientific colleagues, I felt some discomfort about saying how and whether we should control carbon dioxide emissions. Pronouncements on policy weren’t our expertise.

Yet many economists were suggesting policy-based remedies like increasing energy efficiency. Their complex social models offered the appeal of climate solutions without great economic pain.

I thought it might be worthwhile to try to approach the issue in a different way, by considering all the wonders of civilization as part of the physical world. As with the motions of the sun, oceans, or a blade of grass, all of our activities, even our thoughts, must equally be slaves to inviolable physical laws.

Chief among these laws is the Second Law of Thermodynamics which says that nothing can happen without a dissipation of energy in some higher “potential” form. Dissipation sustains circulations in the system while allowing it to do work. Burning high-potential fuel allows pistons in a car engine to circulate and turn its wheels. We consume food with calories to radiate heat while we think, move, and if there is an imbalance, grow.

What does the Second Law imply for civilization growth? And what does it mean for retirement? I believe that my research has shown that fiscal

measures of our global economic wealth have a fixed link to our capacity to dissipate energy. Our total global power production capacity is what ultimately sustains all the world's economic circulations. The two are so inseparable that both have risen in lock-step over the past few decades. Each has more than doubled since 1970. The link between wealth and power has been an average 7.1 +/- 0.1 Watts per 1,000 inflation-adjusted (year 2005) U.S. dollars.

This result is important because it offers the following very simple statement: Global wealth, once it is adjusted for inflation, cannot increase without a commensurate rise in global power production capacity.

I would like to note a common confusion here. The constant correspondence between wealth and power that I claim is not the same as the varying correspondence between GDP and power. Wealth is not current GDP. Rather it is an accumulation of prior production. Neither is wealth some inert stock like the "physical capital" of standard economic treatments. Rather it is a representation of our capacity to interact with each other through our social, transportation and communications networks.

We grew our current wealth of networks from our own prior efforts and those of our ancestors. Maintaining this current network capacity requires that we ceaselessly dissipate potential energy in the form of fossil fuels, nuclear and renewables. Put to an extreme, if current power production were ever switched off, like a house plant without sun, civilization would wither and die.

In a paper that appeared last year in the Retirement Management Journal, I described this relationship more fully. The conclusions made the point that our global wealth and power production capacity are currently growing at a rate of about 2.2% per year, adjusting for inflation. Moreover, even with the Great Recession, this global rate of return has been fairly stable over the past couple of decades, inching upward only very slowly. In an earlier era between 1950 and 1970 by contrast, rates of return doubled.

Stable growth can help us plan. Inertia allows us to expect the coming decade to be characterized by similar returns. While 2.2% may be nothing spectacular, at least it offers some realism to the best and worst of what we may come to expect.

We should keep in mind, however, that the 2.2% figure is a constraint on the globe as a whole. If we see developing countries boom at a faster rate, then we should anticipate that wealthier countries will come off worse. Also, physical considerations tell us that the primary factor that determines how fast we can consume energy is the availability of primary energy reserves. We will remain reliant on burning fossil fuels for quite some time. If reserves of these fuels are suddenly discovered much faster than we consume them, then our energy consumption capacity—and our wealth—should be expected to grow especially fast.

Energy reserves are like our collective retirement account, with their own rate of return.

Booming discoveries of oil accompanied accelerating rates of return in the two decades following World War II. But today, available statistics suggest that our discoveries are only barely keeping up with our rapidly growing consumption. Indeed, physics supports this. Accelerating growth should be expected to be followed by an adjustment to stable growth where discovery and consumption are in rough balance.

I have no qualification to offer investment advice. In any case, the future is essentially unknowable. But I would like to suggest that planning for the coming decade should consider the following: Our capacity to discover and produce energy matters in a very profound way. Energy reserves are like our collective retirement account, with their own rate of return. If discoveries ever flag relative to consumption, then rates of energy consumption must eventually adjust downward. Rates of return on wealth will enter a phase of decline. The tide that lifts all boats may also be the one that lowers them.

About the author: Tim Garrett is an atmospheric sciences professor at the University of Utah and the president of Fallgatter Technologies, a spinoff company that sells meteorological instrumentation. He has written 60 peer-reviewed articles about the atmospheric sciences and on the role of energy in economic growth. In March 2012, his economic work was presented in a keynote for the Retirement Income Industry Association Spring meeting.

Retirement planning for a post-aging world

By Aubrey D.N.J. de Grey

When a key aspect of our world does not change from one generation to the next, we get used to its not changing. If it then starts to change, but very slowly, we have a dangerous tendency not to notice—and when it speeds up a bit, so that it can no longer be overlooked, we have a much more dangerous tendency to pretend that it can safely be ignored. This is a fair summary of the history of life expectancy.

Currently, governments across the world are seeking ways to alleviate an increasingly imminent crisis—even a collapse—of a system that, when Bismarck invented it, imposed an almost negligible burden on the economy, and they are encountering massive resistance from their electorate, who prefer to keep things as they are.

I speak, of course, of the public pension system.



Aubrey D.N.J. de Grey.

I won't speculate here on the prospects for public acceptance of this or that option for the rescue of pensions from their impending predicament. I really don't know whether people will, over time, be readier to accept an increase in the pensionable age, a graded pension system in which one receives more per year after retirement if one chooses to retire at a later age, or a continuation of the shift away from public pensions toward employer-sponsored ones or to living off savings (perhaps buttressed by longevity insurance to guard against one's savings being exhausted).

But in a sense I don't care. That's because all the scenarios that pension funds, governments and other interested parties are currently considering are, in my view, highly likely to become irrelevant within a couple of decades.

That's because the acceleration that we've seen in life expectancy is going to continue—and to do so to a point where it becomes necessary to take