notes from the assabet Vol. X No. 4

Fourth Quarter, 2012

Open and Shut on the NYSE

For 2 days during the assault of Hurricane Sandy, the entire trading apparatus of the New York Stock Exchange was shut down. The stock market closure was not significant to us, given our management style. (It's hard to imagine a scenario in which it would be *critical* to a client's portfolio to trade on Monday instead of Wednesday.) Exchanges and banks lost millions in potential revenues, and some companies delayed earnings announcements. Yet, the two-day hiatus was not a crisis in the financial system. Wednesday opened to low volume and little drama.

Although the closing was relatively benign in outcome, the decision to close was an issue of contention, and raises questions for the future.

For background, realize that in recent history, the stock market rarely closes unexpectedly. It has had a standard list of 9 holidays for 2 decades. The last time it closed for weather was for Hurricane Gloria in 1985. (The last time weather closed the market for 2 days was in the "Great Blizzard" of 1888.) Presidential funerals close the market, as do crises like 9-11 (4 days) or the blackout in 1977, for example.

Between 1873 and 1952, the NYSE was open on Saturdays from 10 am to noon, sometimes taking a break during the summer. Historically, the market was more generous with its holiday schedule and other closings than in the past 2 decades. In many years there were 16 holidays, including Flag Day from 1915 through 1953. Election Day was recognized until 1969. Also: Columbus Day, Veteran's Day, and both Washington and Lincoln's birthdays. Ulysses S. Grant's birthday was celebrated for one year, 1897. (He died in 1885. Go figure…)

War-related closings abounded in the first half of 20th century. From August through December of 1914 the market was closed more often than not. Parades for homecoming heroes merited a stock market holiday: the return of Gen. John Pershing, the 27th Division and the 77th Division in 1919. It closed for two days to celebrate VJ Day (Victory over Japan) in 1945.

Over the years there have been closings for lack of heat (1918) for clerical backup relief (1928) for a week of "banking holidays" during the depression (1933) for a railroad strike (1946) and for a "paper crisis" in 1968 when the number of stock certificates that had to be physically handled and delivered overwhelmed the staff. (Computerized trade clearing began just a few years later.)

Much has changed since 1792 when a group of 24 brokers signed the "Buttonwood Agreement" under a Buttonwood (Sycamore) tree on Wall Street. For decades the NYSE operated as a continuous auction with "open outcry" communication (shouts plus hand signals) as traders gathered around the specialists to buy and sell. Now only a small fraction of U.S. trades are being conducted on the floor at 11 Wall Street. The number of traders and brokers is greatly reduced.

Starting in 2006, things changed radically. The NYSE merged with Archipelago Holdings, an electronic exchange, to form The NYSE Group, a public company with a significant electronic capability. In 2007, the company merged with Euronext NV, creating the first global equities exchange. In 2008, the NYSE acquired the American Stock Exchange. Thus, quite recently, the NYSE Group became a vast, complex, largely electronic hybrid trading company. The physical trading floor which was central to its operation for more than 200 years became only a small yet legendary part. The fact that far more trading is done electronically than on a

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Open and Shut continued

the trading floor, is what makes the 2-day closure of the *entire* NYSE trading network during Hurricane Sandy's damaging visit so interesting.

On Sunday, October 28, with Hurricane Sandy looming, NYSE Euronext announced that it would suspend floor trading on Monday, because of city officials' evacuation order and suspension of transportation affecting the area around Wall Street. Under the NYSE's Business Continuity Plan, the electronic trading exchanges would stay open, with the combined ability to handle all NYSE-listed securities. This made sense because the impending crisis was in NYC while much trading is executed through computers by market makers who could be just about anywhere, and far from the threatened area. Yet many industry observers applauded a later decision to close the *entire* NYSE Euronext for 2 days. They noted that telecommunications can't be established in an instant, from home, for example, and there was too little time to be prepared. Those traders who research, buy and sell securities electronically still have to get to an office where all the sophisticated and secured equipment is located. Employees of the big NYC-based firms would not have been able to trade because it would have been unsafe to travel. Traders outside of NYC with easy access to markets would have had an advantage, jeopardizing a fair and transparent market.

While the safety of systems and trading staff was cited as the major reason for the closing, behind it was a lack of confidence that the alternative electronic system would hold.

This was the theme of those who disagreed with a full closure. They indicated that if access to NYC is necessary, even with extensive electronic exchange opportunities, the operative Business Continuity Plan is worthless.

In discussions following 9/11, alternative market sites and alternative *people* were suggested. The SEC's policy statement recommended that a disruption not last more than a single day. Didn't happen. So, it seems, here we are, with a vast largely-electronic market network, critically dependent upon a small segment of its capabilities. The tail wagging the dog? For all the controversy, the fact is that the 2-day full suspension had little impact on the market.

On December 19, it was announced that NYSE Euronext had agreed to be purchased for $8.2 billion by IntercontinentalExchange, a competitor headquartered in Atlanta. If the deal goes through, future decisions about exchange closings may go in another direction.

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The Potential Costs of Saving Money

We're always impressed by those "handy" people who can DIY (do-it-yourself) many projects for the house, yard or car for which we pay professionals. The motivations to DIY vary from one person to another, but they might include pride in your own accomplishment, enjoyment of the process, a feeling of control, and, of course, saving money. In some cases, the cost savings may make possible a project that would be too expensive to achieve otherwise. However, in certain instances, the risks involved make it wiser to call and pay the professional. Among them:

1) The risk of injury. We all know people who have fallen from ladders, suffered electric shock, chopped into a body part, or inhaled toxic fumes.
2) The risk of doing expensive damage to your home or car from causing a leak, a gouge, or even a fire.
3) The risk of spending time you need for other pursuits. If it's not a pleasurable hobby or you don't have an ample supply of "spare time," you may be held hostage to a project that requires far more time than you had allotted.
4) The risk of disappointment if the finished work isn't up to the standard you *and your spouse* were seeking.

How do you decide whether to DIY or call in a professional? Refer to www.diyornot.com for help on that decision, as well as help with DIY tips. Basically, the right choice depends upon your level of training and experience, the nature of the risks involved, your access to the right tools, the amount of available time and finally, do you really *want* to do this?

Hiring a professional to manage your investments isn't much different. True, your lack of training, experience, tools or time may not result in a concussion or water damage, but poor investment and financial decisions can be as damaging.

Economic and Financial Review

2012 was a year when disturbing headlines tended to obscure slow but steady economic improvement and solid financial market returns. Despite a "wall of worry" that included the possibility of contagion from a European recession and debt crisis, poor job numbers, continued weakness in housing, and the alarming political logjam in Washington, the bigger picture was more encouraging than daily concerns. The U.S. economy has been growing, albeit very slowly. Growth in jobs, consumer spending and confidence continued to be sluggish. However, there was positive news as well. Corporate earnings and balance sheets continued to be strong. Near year-end, both auto sales and construction activity increased. The housing market showed improvement, boosted by historically low mortgage rates, affordability and pent-up demand. European countries are in recession, yet, at least temporarily, with less systemic risk than before. China's economy responded well to the end of monetary tightening and is emerging from recession. Japan remains in a slump.

The Federal Reserve Board came up with a new easing program, guided by two major goals: job growth and control of inflation. With a Federal Funds rate at 0.25%, the Fed cannot reduce it much further. So far core inflation has been contained and policymakers expect it to remain so until 2015.

Equity investors were not daunted by the bad news or slow growth. Equity markets worldwide offered solid returns while performance dispersion across asset categories was historically very narrow. International developed markets and emerging markets outpaced U.S. returns. In the U.S., large cap growth stocks (the S&P 500 Index grew by 16.0%) lagged small caps minimally and mid-caps by more than a point. Value stocks exceeded growth. REITs and financial stocks were the big winners.

There were positive returns worldwide in fixed income assets, thanks to global monetary easing. However, this low inflation/low yield environment is a challenging one for traditional bond investors. Treasury yields have dropped below the rate of inflation, encouraging investors to adopt a multi-sector strategy for fixed income investment. The strongest returns were in the riskiest sectors, emerging market and high yield debt.

As always, there are several potential threats that could undermine the improving economic environment. Chief among them could be the debt ceiling debate, and the implementation of the mandated "sequestration," or automatic spending cuts.

'Tis Better to Give....to yourself?

Just between *us*: were you on your own holiday gift list? According to several retail research firms, the trend of "self-gifting" is rising. It grew by 27% over the past 5 years. The National Retail Federation predicted for 2012 that nearly 60% of holiday shoppers would buy a treat or two for themselves as they shopped for others. Is this a reflection of the "it's all about me" culture?

Perhaps not entirely. Self-gifting can be an efficient practice. You're at the malls anyway, at a time when products are heavily discounted. Retailers have begun to market to self-gifters. Best Buy had an ad for the Samsung Galaxy Smartphone that promoted self-gifting: "If you fancy a little pre-holiday treat for yourself, Best Buy might have something for you." Stores prominently position products that the shopper would buy for herself, such as party fashions and holiday decorations.

These treats may represent a small compensation for self-discipline. American consumers have tightened their belts in the past several years, reducing debt and curbing spending. They may feel ready for a little reward. Or, perhaps we lack confidence that the gifts we receive will be what we want. Certainly they aren't likely to suit us as well as items we choose for ourselves.

Finally, holiday shopping, with lengthy lists, crowded stores and frenzied searches for that special gift is exhausting, rendering us vulnerable to mental confusion. "I just saved $40 on my mom's gift so the $40 that I'm spending on myself is free!" Or: "What's another $140 (the average self-gift expense) when I'm already spending $610 (the average gift expense minus gifts to ourselves)? Research shows that on average, nearly 20% of total gift costs are gifts for the buyer.

So, what did you buy for yourself? I'll go first: I bought a juicer. Practical, healthy and discounted by 25%. The bracelet was discounted by 20% and not pricey to begin with. Same for the other bracelet. :-) The moose ornament for my tree only cost $4 after the 50% sale. Your turn…….

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Can You Afford Not to "Care"?

Volume X no. 4

Occasionally we introduce a specialist in Long Term Care insurance (LTC) to a client. Knowing the potential for extremely steep costs of care, these clients want to investigate ways to manage that risk. Many people with significant assets do not buy LTC insurance. Nationally, only 10% of all seniors have coverage. What explains the widespread decision to do without? In the decision to purchase insurance, we need to evaluate 1) the odds of needing coverage, 2) the probable scope of the liability, and 3) the cost of premiums, all within the context of our own financial situation.

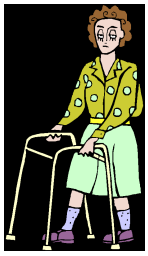
1) With medical intervention lengthening American longevity, the need for long-term care is high. The U.S. Department of Health and Human Services estimates that 70% + of people now 65 years old will need at least some LTC services in the future. Women are more likely to require services. (Have you been to a nursing home or assisted living facility? Men are a rare commodity, much sought after by the ladies.) One study puts the average nursing home stay at 18-20 months. Only 10% of residents stay more than 3 years. And many people receive care in their homes.

2) The cost of care is high, particularly in our region. For the most part, it is not met by health insurance or Medicare. The *average* annual cost of a Massachusetts nursing home private room is nearly $130,000. A private room in an assisted living facility averages $55,00. Home care also can be costly once you factor in homemaker care (housekeeping, cooking and errands) as well as health-related home care ($56,000 for a home health aide for 44 hours a week, and about $51,500 for a fulltime homemaker service provider). Most of our readership would seek care that exceeds average costs. Depending upon the individual case, long-term care costs could be low (staying remarkably fit, healthy and independent until a sudden death) or extraordinarily high (early onset Alzheimer's resulting in many years of nursing home care). The potential expenses could range be from $0 to more than $1 million although it's likely that less than 10% of people have expenses running in the hundreds of thousands of dollars.

3) The final factor in the decision is the cost of insurance, and this is the greatest disincentive to purchasing LTC. Purchasers can adjust the cost by choosing a longer deductible period, a lower daily benefit and a limited coverage period. However, even for less then full and forever coverage, a purchaser of 60 years old would be paying at least $2,000 a year. In addition, we have witnessed turmoil in the industry. LTC providers make their money from the difference between claims paid, and the returns they make investing the premiums. When lapse rates are lower than they anticipated (thus raising the cost of overall claims) and the level of interest rates is lower than expected (thus reducing investment gains) insurers are squeezed. As a result, some companies have significantly hiked premiums while other companies have chosen to exit the business. Potential buyers may fear future cost increases or the loss of the company altogether. Finally, some people may not be able to meet the health-related eligibility requirements.

Most of our clients do not have LTC coverage, perhaps feeling that they could cover the expense of long-term care when it occurs. In all likelihood they could. But they also could cover the expense of other potential hazards for which they readily buy insurance, and the odds of needing the type of care covered by LTC is considerably higher than the probability of losing your house in a fire, for example. Moreover, the assets that could cover long-term care expenses might otherwise be left to loved ones.

Should you consider buying LTC insurance to at least partially cover your risk? Consider the following questions. Are you in your 60s or younger and in good health? Is the $2,000-$3,000 annual premium no greater than 5% of your income? Based upon the experience of your parents or grandparents, are you likely to need more than a year of long-term care? Would the cost of long-term care be financially devastating to you or to your children? If yes to all, you might be a good candidate.



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