

# William Baker

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## Investment Insights

March/April 2011

### NAVIGATING THROUGH THE FOG

Once upon a time, my wife and I found ourselves driving on Interstate 81 near Scranton, PA. It was morning and we drove from clear dry weather into heavy fog. It was a white-knuckle experience. The most frightening thing was the speed. We and all of the cars and trucks around us were barreling along at 65 mph or faster seemingly oblivious to the fact that visibility was next to nothing. Also, many drivers had not even turned on their lights. Would we find ourselves in a chain reaction fog-caused pileup of trucks and cars we hear about in the news or would we get through it OK?

At the first opportunity, meaning an exit off of I-81, we eased away from that accident-waiting-to-happen driving condition. We then made our way at a much slower and safer pace to one of those exit restaurants. Thank God! We were off I-81, inside safe-and-sound, waiting for the fog to lift before getting back on the road.

That experience was much more dangerous than flying into an airport in the dark of night and in the rain. In that case an air controller is there to help guide you in safely. The risk of driving in the fog is that there is no way to control, anticipate, or bottom-line-see, what another of the many drivers on the road might or might not do in terms of slowing down, speeding up, or stopping. We were at very high risk of being in a bad accident.

To paraphrase one of my own quotes, successful investing is not so much chasing after high risk gains as it is avoiding large, difficult-to-recover losses. Investing, just like driving, occurs under different and variable conditions. Sometimes the weather is clear and dry, the road is construction- and accident- free and it's easy to make good mileage. At other times the weather is bad, road conditions may be snarled and the going can be very dangerous and/or very slow.

Our recent newsletters and bulletins have relayed that the major indices are inflated from a price and value standpoint and that since last October, longer maturity interest rates have been steadily rising. Those conditions historically have not ended well for the equity markets.



Our premise is that much of the inflated pricing in the stock market is being driven by central-bank-created funny money, not economic fundamentals. This in effect is an unstable situation that could very quickly drive the markets into more realistic valuations. That could result in a precipitous and rapid drop in prices. At this point we are within weeks of an end to the stimulus package and yes the conditions are very foggy right now.

Our investment methodology includes corroborating technical or supply-and-demand research with fundamental or micro/macro-economic research.

Our technical research now is showing that demand or higher prices remain in control but at a high level of risk (i.e. inflated values and prices). Fundamental research includes an almost infinite amount of data but a few basics are: the job picture is very slowly improving, legislation spurring the natural gas industry could occur and be very beneficial to our economy, the national debt situation is being debated, the housing market remains very damaged, the banks continue to shall I say simmer if not cook their books, K through 12 public education is unsatisfactory, rising oil prices are a real concern to continued recovery, necessary reforms or checks-and-balances are wallowing against big-money lobbying and continued underfunding. A very bright spot is that emerging markets with a growing middle class and increasing consumer demand will continue to stoke the furnaces of the U.S. and other developed world economic engines. *(continued on next page)*

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#### S&P 500 Look back

2000	-9.11%
2001	-11.89%
2002	-22.10%
2003	+26.68%
2004	+10.87%
2005	+ 3.00%
2006	+13.62%
2007	+ 3.52%
2008	-38.5%
2009	+18.9%
2010	-11.33%

#### NASDAQ Look back

2000	-39.18%
2001	-20.78%
2002	-31.25%
2003	+50.76%
2004	+9.14%
2005	-1.4%
2006	+7.87%
2007	+ 9.27%
2008	-40.5%
2009	+30.5%
2010	+14.46%

YTD thru 4/29/11

S&P500	+8.33%
NASDAQ	+8.31%

10/11/2007 HI thru 4/29/11

S&P500	-12.25%
Mar 2000 HI thru 4/29/11	
NASDAQ	-43.09%

\*There is no risk-free investment! Investment portfolio values fluctuate and past performance is never a guarantee of future results. "Do no harm" translates into structuring and managing an investment portfolio to conform to a client's risk tolerance and time horizon. Proactive asset allocation, diversification within asset classes, and continual monitoring and risk management of each position are methods we use in structuring and managing portfolios. Our approach includes corroborating fundamental research, with capital markets supply-and-demand research, also called technical research. At times we will use conservative hedging techniques to limit downside risk.

(continued)

In summary, the technical picture is showing that demand is in control but at a high level of technical risk. The major indices have broken into new recent high territories and a broad range of stocks are showing positive trends and positive momentum. These signs could point to another leg up in the equity markets but could also turn, on a dime, down, at this level of risk. Fundamentally, stock valuations are high and interest rates are rising—conditions that historically are bad news for the stock market. The when, of changes in market direction, is unpredictable. Therefore, we deal with what is, and right now what is, is a high risk investment scenario in which stocks are still moving higher similar to driving fast in foggy conditions.

Our portfolios are presently structured to participate in the upside as the markets have moved up and may continue to move up. At the same time we also have some assets on the sidelines in money markets and in fixed income securities. We also have exit strategies for each of our positions. This approach would somewhat help insulate portfolios from sudden downturns in the equity markets. We continue to do daily due diligence and make portfolio adjustments in line with our investment management mantra **"Do no harm and make money."** \* (Please read the sidebar)

## FIVE QUESTIONS ABOUT LONG TERM CARE

### 1. What is long-term care?

Long-term care refers to the ongoing services and support needed by people who have chronic health conditions or disabilities. There are three levels of long-term care:

- **Skilled care:** Generally round-the-clock care that's given by professional health care providers such as nurses, therapists, or aides under a doctor's supervision.
- **Intermediate care:** Also provided by professional health care providers but on a less frequent basis than skilled care.
- **Custodial care:** Personal care that's often given by family caregivers, nurses' aides, or home health workers who provide assistance with what are called "activities of daily living" such as bathing, eating, and dressing.

Long-term care is not just provided in nursing homes--in fact, the most common type of long-term care is home-based care. Long-term care services may also be provided in a variety of other settings, such as assisted living facilities and adult day care centers.

### 2. Why is it important to plan for long-term care?

No one expects to need long-term care, but it's important to plan for it nonetheless. Here are two important reasons why:

**The odds of needing long-term care are high:**

- Approximately 40% of people will need long-term care at some point during their lifetimes after reaching age 65\*
- Approximately 14% of people age 71 and older have Alzheimer's disease, a disorder that often leads to the need for nursing home care\*\*
- Younger people may need long-term care too, as a result of a disabling accident or illness

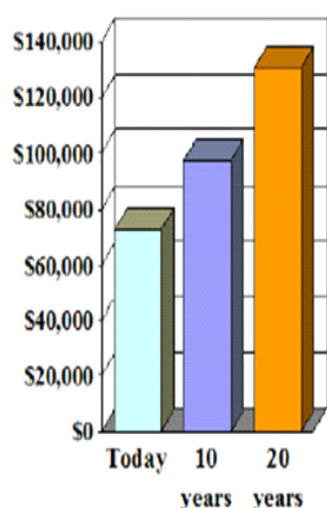
### The cost of long-term care is rising:

Currently, the average annual cost of a 1-year nursing home stay is \$72,270\* and in many states the cost is much higher. In the future, long-term care is likely to be even more expensive. If costs rise at just 3% a year (a conservative estimate), in 20 years, a 1-year nursing home stay will cost approximately \$130,528.

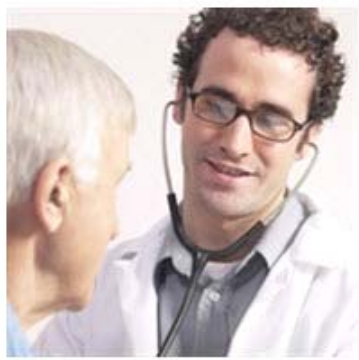
\*National Clearinghouse for Long-Term Care Information, U.S. Department of Health and Human Services, 2009

\*\*Alzheimer's Association, 2010

**The Rising Cost of Long-Term Care**



*Long-term care is not just provided in nursing homes--in fact, the most common type of long-term care is home-based care.*



*Understandably, many people put off planning for long-term care. But although it's hard to face the fact that health problems may someday result in a loss of independence, if you begin planning now, you'll have more options open to you in the future.*

**3. Doesn't Medicare pay for long-term care?**

Many people mistakenly believe that Medicare, the federal health insurance program for older Americans, will pay for long-term care. But Medicare provides only limited coverage for long-term care services such as skilled nursing care or physical therapy. And although Medicare provides some home health care benefits, it doesn't cover custodial care, the type of care older individuals most often need.

Medicaid, which is often confused with Medicare, is the joint federal-state program that two-thirds of nursing home residents currently rely on to pay some of their long-term care expenses. But to qualify for Medicaid, you must have limited income and assets, and although Medicaid generally covers nursing home care, it provides only limited coverage for home health care in certain states.

**4. Can't I pay for care out of pocket?**

The major advantage to using income, savings, investments, and assets (such as your home) to pay for long-term care is that you have the most control over where and how you receive care. But because the cost of long-term care is high, you may have trouble affording extended care if you need it.

**5. Should I buy long-term care insurance?**

Like other types of insurance, long-term care insurance protects you against a specific financial risk--in this case, the chance that long-term care will cost more than you can afford. In exchange for your premium payments, the insurance company promises to cover part of your future long-term care costs. Long-term care insurance can help you preserve your assets and guarantee that you'll have access to a range of care options. However, it can be expensive, so before you purchase a policy, make sure you can afford the premiums both now and in the future.

The cost of a long-term care policy depends primarily on your age (in general, the younger you are when you purchase a policy, the lower your premium will be), but it also depends on the benefits you choose. If you decide to purchase long-term care insurance, here are some of the key features to consider:

- **Benefit amount:** The daily benefit amount is the maximum your policy will pay for your care each day, and generally ranges from \$50 to \$350.
- **Benefit period:** The length of time your policy will pay benefits (e.g., 2 years, 4 years, lifetime).
- **Elimination period:** The number of days you must pay for your own care before the policy begins paying benefits (e.g., 20 days, 90 days).
- **Types of facilities included:** Many policies cover care in a variety of settings including your own home, assisted living facilities, adult day care centers, and nursing homes.
- **Inflation protection:** With inflation protection, your benefit will increase by a certain percentage each year. It's an optional feature available at additional cost, but having it will enable your coverage to keep pace with rising prices.

**Deductions for Long-Term Care Insurance Premiums: 2010 & 2011**

Age	2010 Limit	2011 Limit
40 or under	\$330	\$340
41-50	\$620	\$640
51-60	\$1,230	\$1,270
61-70	\$3,290	\$3,390
70+	\$4,110	\$4,240