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A new study says an investment in commodities can help a portfolio keep up with inflation. See story on page 3.

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Retirees who focus on yield are missing the boat when it comes to beating inflation. See story on page 4.

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Lesson from Wilma: Be Prepared

Those of us living in Southern Florida recently struggled to recover from Hurricane Wilma. The damage from the storm affected our critical infrastructure (electricity, communications, etc.) more than our offices or homes.

There are many lessons we can learn from Wilma. At the top of the list is preparing for contingencies. We constantly adapt to circumstances we can't predict, almost on a moment by moment basis.

Yet most days are filled with ministerial acts; there may not be a lot of time for thinking about or preparing for unforeseen events.

Well, this is the first lesson from Wilma—take the time.

Prepare your home, workplace, family, finances, and most importantly, your mind. Crisis situations often play out poorly for those who don't think about them in advance.

The government suggests you keep 72 hours of food and water on hand at all times. Well, not too many people do this as evidenced by the

lines seeking provisions after the storm.

It won't happen to me

Yeah, that's what we said, too. Hurricanes affect a lot of our country, but so do earthquakes, blizzards and other weather related crises. No one is immune to being without electricity, even in good weather.

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Lessons to learn

Preparation is key to crisis recovery:

- ⇒ It can happen to you no matter where you live.
- ⇒ Backup systems for electricity and communications are critical to your success.
- ⇒ Planning for several days without power includes



adequate food and water supplies, currency and communications systems to keep in touch with friends, loved ones, customers and workers.

⇒ Investments don't care about you. Be prepared to let your investments manage

We are an electricity (or natural gas) dependent society. Provide for a backup—buy a generator, and keep adequate supplies of fuel on hand.

Keeping food cold and having ice from your refrigerator goes a long way to maintaining your family during a power outage. Power for satellite TV, computers (having internet access), lights and the like will make you the envy of the struggling masses.

Cash is king

When there is no electricity to run cash registers, all that plastic doesn't do much good. Keep some currency around, at least a few hundred dollars.

Paying someone to clear the trees out of your yard is very hard to do with plastic. The ATMs won't work without electricity. If a store is open, and many do open on backup power, goods you might really need could be available. And if you don't have the cash, you'll go needy.

(Continued on page 2)

How 'anchoring' obscures investment values

(Editor's note: This is the second in a series on cognitive errors and emotional biases that hinder investment success)

Our minds work in funny ways, and one of the most fascinating traits involves our tendency to hang our decisions on irrelevant information.

Behavioral psychologists call this tendency "anchoring." We see it in the investment markets when investors come to regard the price at which they bought an investment as more significant than any other price.

Pernicious influence

Researchers have conducted fascinating studies showing how an irrelevant number can influence decisions just because the number is presented first.

For instance, the late Amos Tversky and Daniel Kahneman, who teaches at Princeton, asked people how many African nations were in the United Nations. Before allowing an answer, a wheel of fortune with numbers from one to 100 was spun and participants were asked how much higher or lower their answer

was than the wheel's number.

Even though it was obvious that the number on the wheel had no relation to the answer, participants who got a 10 on the wheel, for instance, gave a median answer of 25 nations, while those who got a 65 on the wheel gave a median answer of 45. It appears that the wheel influenced their answers.

Even experts can be fooled by starting numbers. In another study two sets of realtors were shown a house and

given a packet of information on it. One group was told the house listed at \$69,500. The other group was told it listed at \$83,900.

Despite being shown the same house with identical information except for the listing price, the realtors who were given a higher listing price gave a much higher median estimate of value.

Stock price anchors

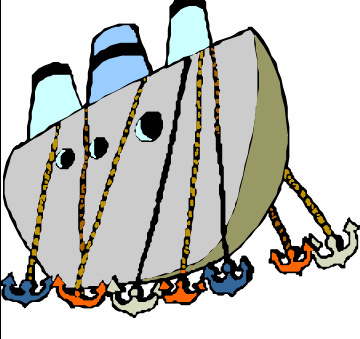
Investors often get fooled into holding rather than selling a stock because they are waiting for its price to "come back" to the price they originally paid.

That's because they anchored on their initial purchase price, attaching more significance to it than does the rest of the stock market. Even though the stock they bought for \$130 currently sells for \$65 - *and most other investors believe it is only worth \$65* - the anchored investors stubbornly believe their stock is supposed to sell for \$130.

This can also happen when a stock reaches a high and subsequently drops, some investors may consider it a bar-

Dropping Anchor

Our tendency to focus on irrelevant information when making decisions is a sign of anchoring:



⇒ *An unrelated number presented at the outset of a question will influence your answer to the question.*

⇒ *Experts have been fooled in studies by the introduction of arbitrary numbers.*

Wilma says: "Prepare for no power"

(Continued from page 1)

Have a plan

Boy, that's easier said than done. There are a lot of things to plan for: security of your home, your workplace if self employed, documents that need to be safe and dry, etc.

At home, in addition to the generator, plenty of food, water, ice, batteries, radios and the like, have some sturdy tools (gasoline powered), work clothes and gloves, and first aid supplies galore.

At work, be sure your critical computer systems are backed up. Have a contingency plan for working from a different location if you can. Your home could be fine and your business location inoperable at the same time. Make sure you have key contact information for employees and customers handy.

Are the originals of your wills, trusts, deeds, car titles,

etc. in your safe deposit box at the bank? They should be. Where are your insurance policies? You could need them in a crisis, so keep them in a watertight container, with copies in your bank box.

Investments don't care about your problems

It sure would be hard to actively trade stocks without power or a phone. Try keeping track of your stocks while

you're on a daily scavenger hunt for water and ice. How could you possibly make intelligent trading decisions at the same time?

Why not create an investment plan that's based

on sound policy that doesn't require moment by moment monitoring? A diversified portfolio of low cost mutual funds can be your answer.

What a good feeling it can be not to worry about your retirement money while trying to recover from a crisis. Focus on the important parts of your life-your family and

It sure would be hard to actively trade stocks without power or a phone, especially if you're hungry and thirsty.

Should your portfolio include commodities?

Putting a portion of your money into commodities futures may help to shield your portfolio from inflation while buoying it up during stock and bond market declines, conclude two university professors.

Gary Gorton of the University of Pennsylvania's Wharton School and K. Keert Rouwenhorst of Yale University say their study showed that commodities were less risky than stocks over long periods of time and that commodities gained in value during periods when stocks and bonds fell.

"During the 1% of months of lowest performance of equity markets, when equities fell on average by 13.87% per month, commodity futures returned an average of 2.36%," they wrote. "It seems that the diversification benefits of commodity futures work well when they are needed most."

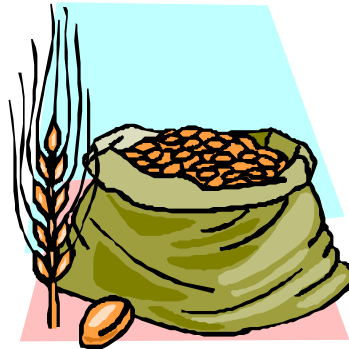
Stocks vs. commodities

Commodities are the opposites of stocks and bonds. Commodities represent hard assets - oil, industrial metals, grains, gold, etc.

Betting on Hard Assets

Wheat, oil, gold, and other commodities may help your investment portfolio, a recent study says:

- ⇒ *Commodities futures go up when inflation rises, offsetting falling prices in bonds and stocks.*
- ⇒ *Commodities help to smooth out a portfolio's returns.*
- ⇒ *Commodities earn a positive return that is safe and with less downside volatility than stocks.*



Gorton and Rouwenhorst used the Goldman Sachs Commodities Index, which began in 1991, and also constructed a simulated index of commodities going back to 1970.

They noted that other studies of commodities were not useful because they relied on shorter time periods.

They found that over longer periods of time commodities futures were correlated with inflation, meaning they earned more money when inflation was rising, which is also a time when stocks and bonds are usually falling.

They also found, to their surprise, that commodity futures - which are very volatile over short periods - are less risky than stocks over longer periods.

Stocks and bonds, meanwhile, are intangible claims on future cash flows of corporations and governments.

Commodities investors usually don't buy and hold the physical asset; instead, they buy or sell futures, which are claims on a specific commodity at a specific price on a specific future date (for instance, a claim to purchase 100 barrels of oil at \$70 per barrel at the beginning of December).

Other investment researchers have disputed this claim. They argue that constructing a simulated index is faulty because the components used are affected by selection bias.

Studies done solely on the "live" commodity returns captured by the Goldman Sachs index since 1991 show that the inclusion of commodities in a portfolio did not significantly reduce

IAP's new logo, risky mortgages, & more

IAP introduces new logo

We're proud to introduce our new logo! Watch for it on our web site, letterhead, and business cards.

A firm specializing in communications for advisers developed the logo for us with some of our input.

Let us know what you think.



Risky mortgages

Interest-only mortgages now account for over half of new mortgages, according to industry statistics gathered by LoanPerformance.

They allow homebuyers to reduce their payments by making only interest

payments for up to 10 years. Eventually the interest rate floats with market rates and borrowers must begin repaying principal as well.

Industry observers worry that they will backfire on borrowers in the future if interest rates go up and the borrowers cannot afford larger payments.

Final warning from Greenspan

As he heads off into the sunset of retirement from the Federal Reserve Board, Alan Greenspan delivered a serious warning to investors in late August: Don't forget about risk.

He worried that investors - by accepting relatively low rates of return on stocks, bonds and real estate - think the economy has become less risky.

"History has not deal kindly with the aftermath of protracted periods of

low risk periods," he warned.

He also said he worries that investors seem to be more willing to spend money based on changes in their wealth, rather than in their income.

Indexed annuities investigated

Among the most popular new financial products are indexed annuities whose performance is tied to the stock market but which also offer a rate guarantee.

Now the SEC and the National Association of Securities Dealers are investigating sales practices that they say may mislead customers.

The two organizations say the 7.6% to 13% sales commissions on the products may be encouraging sales people to make unfounded claims for returns or to gloss over costs and lock-up periods



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Why you cannot switch to bonds after retire-

A common misconception among investors is that an investment portfolio in retirement should be conservative because a retiree cannot afford to "lose" money.

Unfortunately, investors often use the wrong definitions of the words "conservative" and "lose."

Too often they are worried about current and usually short-term - market fluctuations.

They fear "losing" money when the stock market falls. That temporary decline in value represents a loss of principal and potential retirement security.

They feel safer investing in a bond or other fixed income instrument that pays an interest rate and that doesn't fluctuate much in value. That way, they live off of their "income" and protect their "principal."

These misperceptions of interest earned with "income" can be so wrong as to seriously damage a retiree's chance of living comfortably throughout retirement.

A retiree who hopes to live for 20 or 30 years cannot



Interest rates are a bad predictor of overall returns.

base his investment portfolio on "income" earned through the yield on his investments. History proves that the highest-yielding investments have lower overall returns than lower-yielding investments.

Even worse, higher-yielding investments often have trouble keeping up with inflation, and inflation is a retiree's biggest financial enemy, not temporary fluctuations in the stock market.

Consider the last 50 years, a period during which bonds and Treasury Bills have usually offered much higher yields than did stock dividends.

Yet the returns on bonds and notes barely kept ahead of inflation on an after-tax basis. Treasury Bills had an average annual return of about 5% during this period, just ahead of inflation's 4% annual gain, while five-year Treasury Notes returned about 6.9% per year.

Meanwhile, the U.S. stock market, as measured by the Standard & Poor's 500 Stocks index, returned 10.4% per year, nearly three times the rate of inflation.

Retirees should emphasize total return - yield plus market appreciation - and include stocks in their portfolios.